USAID
FROM THE AMERICAN PEOPLE

FACILITATING THE DEVELOPMENT OF OUTGROWING OPERATIONS

A MANUAL

AUGUST 2009
This publication was produced with funding from the Agency for International Development. It was prepared by Action for Enterprise.

Facilitating the Development of Outgrower Operations: A Manual

Produced under:
The FIELD-Support LWA

Cooperative Agreement No.
EEM-A-00-06-00001-00

Managed by:

The Academy for Educational Development

Disclaimer

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

Prepared for: USAID/EGAT/PR/MD

Prepared by: **Action for Enterprise**
2009 N.14th Street
Arlington, VA USA
+1 703 243 9172
www.actionforenterprise.org

Match Makers Ltd
Dar es Salaam /Arusha, Tanzania
+255 784 449 590
www.mma-ltd.com

Version: 1.0

TABLE OF CONTENTS

APPENDICES

Acknowledgements

Many individuals with in-depth experience and knowledge of outgrowing operations contributed to the development of this manual. They include representatives of East Africa Growers (Kenya), Multi-Flower Ltd (Tanzania), Pepsi-Co (India) and ITC (India). Case studies of these companies are part of this initiative and are included as appendices to the manual. In addition, several AFE-collaborating companies in Bangladesh contributed their insights and experiences. The authors of the manual include development professionals with many years of experience supporting outgrowing operations and a keen interest in promoting market-based and sustainable solutions to constraints facing agricultural producers.

Outgrowing operations can be instrumental in aggregating the production of small scale producers (outgrowers) so they can participate in larger, more demanding domestic and international markets. Outgrowing operations not only benefit producers through the improved inputs, technology and technical assistance that companies (buyers) operating such schemes provide them, they also can assist development organizations (DOs) promoting this strategy to achieve their goals of creating sustainable impact for producers and advancing the competitiveness of developing country industries.

This manual is meant to be used as a practical field tool to help DOs *facilitate* the development of outgrowing operations between companies and producers. Users can employ manual components either individually or together to achieve this goal. While designed primarily to assist DOs develop new operations, users can easily adapt the tool to work with companies that have existing outgrowing operations.

Action for Enterprise would like to thank the USAID FIELD Support LWA program staff for their financial and technical support, without which this initiative would not have been possible. AFE also would like to recognize the excellent contributions made by Match Makers Ltd., based in Tanzania and a full partner with AFE in this initiative. Finally, special thanks to all of the companies that participated in the case studies and generously shared their time, knowledge and experiences.

Introduction

The principle objective of this manual is to provide development organizations (DOs) with knowledge and tools that can assist them build the capacity of companies (buyers) to develop and operate mutually beneficial outgrowing operations with farmers.[1] The manual is divided into five sections.

Section One contains a series of fourteen **Question Guides** that present the critical questions and decisions that a company must make before engaging in an outgrowing operation. DOs can use the questions to guide a company through the thinking that needs to take place, the decisions that need to be made, and the tasks that need to be carried out to help ensure the successful development and operation of an outgrowing operation. Following each question are bullet points that present useful information, strategies and experiences from existing companies that DOs can use to help a participating company establish its own operations, strategies and policies.

Section Two presents **General Lessons Learned**, from a company perspective, on managing outgrowing operations. These points are drawn from existing companies as well as technical specialists who have a broad range of experience. ***Section Three*** addresses the critical issue of **Side Selling**[2] and presents a range of strategies and methods that companies can use to help avoid this.

Section Four presents the **Role of the Development Organization in Facilitating the Development of Outgrowing Operations**. This section, from the perspective of a DO, presents principles and lessons learned that can help a DO structure its collaboration with targeted companies in a way that maximizes the chances of success and sustainable impact—for both the company and the producers they buy from who are, in most cases, the ultimate DO target group.

Section Five comprises a series of **Intervention Briefs** that provide concrete and practical examples of how DOs can help build the capacity of companies to successfully develop and manage the different outgrowing operation components. Each brief presents examples of capacity-building activities, cost-share options and the typical mistakes that DOs make.

The ***Appendices*** introduce **Case Studies** of outgrowing operations in Asia and Africa. These cases provide real life examples of how companies are managing outgrowing operations and how DOs are helping to build their capacity to do this.

[1] Outgrowing operations (also referred to as contract farming) can be defined as agricultural production carried out according to an agreement between a company (buyer) and farmers.

[2] Side-selling occurs when a farmer who has an agreement to sell to a company (and who may receive technical support, inputs on credit, etc) sells to a different buyer.

I. Question Guides

This section presents a series of fourteen **Question Guides** that present the critical questions that a company needs to ask, and decisions they need to make, before engaging in an outgrowing operation (the guides can also be adapted for companies already engaged in outgrowing operations). DOs can use the questions to guide a company through the thinking they need to engage in; the decisions they must make; and the tasks they need to carryout to ensure the successful development and operation of an outgrowing operation. Bullet points following each question in the guides present useful information, strategies and experiences from existing companies that DOs can use to help a company establish its own operations, strategies and policies.

Question guides in this section cover the following outgrowing operation components

1. Deciding to Establish an Outgrowing Operation
2. Hiring Staff for Outgrowing Operations
3. Selecting and Engaging Lead Farmers
4. Selecting Outgrowers
5. Communicating with Outgrowers
6. Providing Technical Assistance to Outgrowers
7. Providing Credit to Outgrowers
8. Ensuring Outgrower Access to Appropriate Inputs, Including Seed
9. Determining Price for Outgrower Produce
10. Procuring from Outgrowers
11. Developing a Seed Program
12. Developing Demonstration Plots
13. Developing Trial Plots
14. Management Information Systems

QUESTION GUIDE #1

DECIDING TO ESTABLISH AN OUTGROWING OPERATION

Why are you considering an outgrowing operation and how do you expect it to contribute to your company's operations, competitiveness and/or growth?

A company needs to consider many things before establishing an outgrowing operation. Given the investment and long-term commitment needed to make outgrowing successful, a company should not take the decision lightly and should carefully weigh the potential risks and rewards. The following questions can help guide the company in making an informed decision.

1) What advantages would an outgrowing operation provide your company compared to the way you now source raw materials and products?

The incentives and benefits of outgrowing operations for companies include:

- Helping them adapt to domestic and international trends towards higher quality
- Ensuring a reliable source of raw materials
- Assisting them respond to market requirements for high quality
- Allowing them to produce to buyer specifications (and to target different market segments that have particular specifications)
- Providing risk diversification by developing ensured sources of supply in different geographic areas
- Helping mitigate the risk of crop failures (due to poor weather, plant disease, etc) by sharing this risk with producers
- Providing greater flexibility to respond to market demands—when demand is strong they can increase orders with farmers, when demand is low they can decrease orders
- Enabling them to engage in large-scale production without a huge capital outlay for land and infrastructure
- May mitigate risks associated with crop disease in a contiguous farm area by contracting with farmers in smaller, geographically-diverse areas
- Helping them avoid high labor costs (and conformance to labor laws) through subcontracting
- Allowing them to focus on processing and marketing functions by outsourcing production
- Providing good public relations with government and the public through demonstrated benefits to participating farmers
- Allowing expansion of crop production when commercial farming land is limited
- Enabling companies to target and access certain high premium / niche markets (fair trade, organic, etc.) that require direct relationships with farmers (production monitoring, technical support, etc.)
- Allowing them to differentiate themselves from competitors
- Helping companies procure raw materials / products locally rather than importing them (import substitution).

Note: Companies need to recognize that, in most cases, an outgrowing operation is not likely to result in lower costs of raw materials (compared to existing methods of procurement from traders, etc.), at least not in the first few years. Once an outgrowing operation achieves economies of scale, per unit procurement costs can begin to decrease. However, if a company's only motivation for engaging in such a scheme is to pay less for raw materials (without concern for quality, volume, new varieties, etc.) then it may not be appropriate for them.

2) What are the immediate and long-term prospects for your end-market (the market to which you intend to sell products you procure from outgrowers, either in raw or processed form)? Does an outgrowing operation make sense given this scenario?

There must be strong demand for the company's final product to justify investing in an outgrowing operation and ensuring its success. Since outgrowing operations require substantial investment and a company does not want to find itself in a situation where it cannot sell the products it is producing, it must have or be very confident of achieving, strong demand for its end-market products before investing in such a scheme. Not only would weak demand result in losses for the company, the need to cut back or suspend purchases would undermine its relationships with producers.

3) What risks and challenges might you face in developing an outgrowing operation?

In discussing risk, you must first determine whether your targeted commodity is part of a *closed* or *open* marketing system. These systems are defined as follows:

- **Closed marketing systems** exist when it is difficult or impossible for outgrowers to sell the crop to other buyers. In this scenario the company faces a lower risk of *side-selling* (when an outgrower sells to another buyer despite an agreement to sell to the outgrowing company) and is therefore more willing to invest in its outgrowers. Outgrowing operations are easier to manage and develop in this case.
- **Open marketing systems** exist when there are ready markets (many buyers) for the crops produced by outgrowers. Under an open marketing system the risk of *side-selling* is much greater and, therefore, *the risks to the company are also greater*. Different methods of organization are required in open marketing systems to address the inherent risks.

Since outgrowing operations are ***much riskier in open marketing systems,*** companies need to have different / additional systems to address those higher risks. The following points elaborate many of the risks / challenges companies encounter with outgrowing operations. ***Note***: they also may be present in closed marketing systems.

Companies engaging in outgrowing operations may encounter the following risks / challenges:

- If there is *side-selling*[3] by farmers the company can face losses as well as difficulties in meeting the commitments they have with their own buyers

[3] *Side-selling* refers to a situation in which a farmer who has an agreement to sell to a company that is participating in its outgrowing operations sells instead to another buyer.

- If farmers do not use the inputs provided them for the outgrowing operations, this could result in: 1) lower productivity and quality and 2) difficulty in paying back the credit they received for inputs
- Establishing an outgrowing operation can entail significant start-up costs and require a long-term horizon in order to achieve economies of scale and positive returns for the company
- It can be difficult to access financing for outgrowing operations (banks tend to be unfamiliar with them)
- Development of an outgrowing scheme in a particular area can bring in additional buyers and competitors
- Outgrowing operations are subject to the same challenges and risks that all agricultural production strategies face (natural disaster, disease, complexity of operations, weather, acquiring needed inputs, etc.)
- Starting with a new crop, unfamiliar to farmers, is more costly and time consuming than starting with a crop with which farmers are already familiar
- Sometimes the local enabling environment (marketing boards, restrictions on purchasing from farmers, lack of tax incentives, shortage of government subsidized inputs, etc.) is not conducive to establishing outgrowing operations
- In some situations, outgrowing operations may face high turnover of company extension staff, which can lead to higher costs.

4) Why would farmers be interested in participating in your outgrowing operation?

It is critical that companies recognize that an outgrowing operation is a partnership with producers and if it is to succeed, they must ensure that the producers are satisfied with the benefits they receive. Benefits can take many forms including higher productivity and earnings, greater knowledge, access to inputs, and guaranteed markets.

Advantages for farmers include:

- A guaranteed buyer permits them to focus on producing, rather than marketing their products
- Access to better seed and other inputs (sometimes in the form of credit)
- Access to technical support in crop production and new technologies leading to higher yields and productivity, the ability to produce new crops and transformation into more highly skilled and commercially-oriented farmers
- Receipt of immediate feedback from buyers
- Ability to produce traditional, non-traditional and higher value crops for broader export or domestic markets that they could not access individually
- A diversified crop portfolio
- A peer learning process with other farmers participating in the outgrowing operation
- Procurement / payment procedures that are (generally) more transparent.

5) What risks would farmers participating in your outgrowing operation face?

Risks for farmers include:

- Company sometimes cannot respect their purchasing agreement (due to volatile markets and other factors) which can lead to losses for farmers
- Farmers investing too much land, time, etc. in an outgrowing crop may leave them open to greater potential losses if the operation does not succeed
- Over reliance on cash crops (without a ready alternative market) can increase risks if the crop fails or if the buyer cannot respect the agreement. Cash crop proceeds might also result in household disruptions if the producer does not used them judiciously
- Farmers may become overly indebted if production is unsuccessful
- Difficulty in assessing company reliability and risks associated with growing new crops.

6) Which outgrowing organization model do you want to use?

The company has to determine the model of outgrowing it wants to use. There are two principal models – the ***direct model*** and the ***indirect (or intermediary) model*** – as well as variants such as the ***nucleus estate model*** in which the company produces some of the required product on its own or leased land and engages outgrowers for the remaining production. The company also may decide to purchase or lease land for seed multiplication.

The choice of model depends on many factors and need not be an either / or decision. In certain situations, companies may use a combination of operational models, for instance they could begin with a directed model and a move to a more indirect model. The choice can also be influenced by the number and location of outgrowers as well as company staff capacity.

DIRECT MODEL: In a direct or centralized model the company has field agents that interact directly with the individual farmers with whom the company contracts. The directed method may be most appropriate in the following situations:

- Production of high value crops
- When the company has a higher margin on its final product (which can justify the greater expense of the directed model)
- When farmers are not familiar with the new crops
- When there are more complicated production systems
- When there are high buyer specifications (e.g., quality, traceability, pesticide levels, etc.)
- When crops require traceability to individual producers
- Where farmers produce a majority of the production the company needs (the direct model can reduce company risk by ensuring close cooperation with producers)
- In conjunction with a *nucleus/estate model* where a company has a large plantation and then contracts with individual farmers on the periphery.

Advantages of the direct model include:

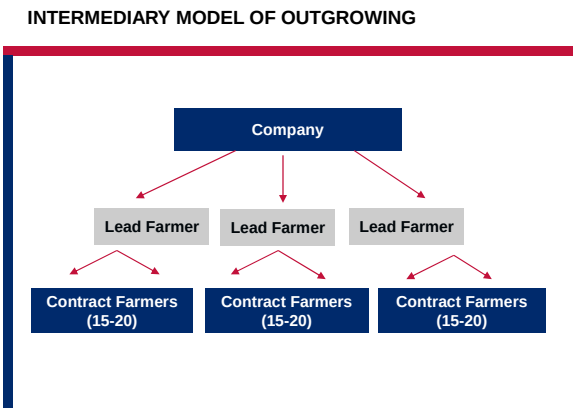
- Assurance of clear communication and direct transactions with farmers
- Close monitoring and direct feedback from farmers
- Traceability of production to individual farmers

- Company can respond promptly to farmer issues
- Greater assurance that farmers will apply correct crop production practices.

Disadvantages of the direct model for companies include:

- Requires more personnel to ensure a high ratio of company extension staff to outgrowers, resulting in higher costs per outgrower and for operations
- The number of outgrowers and the company's geographic coverage is limited
- Slower scale-up pace
- May limit the integration of smaller farmers (due to need for cost effectiveness / value achieved for each outgrower).

INDIRECT (INTERMEDIARY) MODEL: In this case company field agents interact with *lead farmers* who serve as intermediaries between the firm and outgrowers for **specific functions.**



This model may be appropriate in the following situations:

- Company needs to have lower cost per outgrower for commercial viability
- Production of crops with lower value (producing lower margins for the company)
- Crops for which farmers already have technical expertise
- When buyer requirements and specifications are not high (quality, traceability, pesticide levels, etc.)
- For crops that don't require traceability to individual producers
- Where there is a need to integrate large numbers of small-scale farmers into the outgrowing operation.

The advantages of the indirect (intermediary) model include:

- Requires lower ratio of extension staff to outgrowers (resulting in lower costs per producer)
- Potential to reach more outgrowers in a larger geographic area
- Can allow quicker scaling up
- Requires smaller management structure, number of personnel and operational costs
- Can integrate smaller farmers.

The disadvantages of the indirect model include:

- Loss of direct communication (and greater risk of miscommunication) with individual farmers
- More difficult to introduce and monitor complicated production systems
- More difficult to get direct feedback from farmers (due to indirect monitoring)
- Difficult to trace production to individual farmers
- Can take a longer time to recognize and respond to farmer issues
- Less assurance that correct crop production practices will be applied
- Risk of lead farmers promoting their own interests or taking advantage of a situation with outgrowers in their group and/or with the company.

7) What are the projected costs of your outgrowing operation?

Companies must recognize the costs involved in establishing a successful outgrowing operation and be ready to absorb them before they begin. Knowing the costs, the company must come to the conclusion that the investment in the outgrowing operation is going to have a net positive return (benefit) for the company over the long term.

The definition of these costs depends to a large extent on the structure of the proposed outgrowing operations and the decisions and choices made using the Question Guides *(costs can be determined progressively while going through the guides).*

The company should consider the following illustrative cost elements:

- Outgrowing operation staff (coordinator, field agents, etc.)
- Staff transportation and communication costs
- Fees or commissions for lead farmers
- Training for staff / outgrowers
- Trial / demonstration plots
- Interest payments on financing
- Seed and/or other inputs (can be recaptured at time of purchase)
- Payment to outgrowers
- Warehouse rental
- Processing of raw materials (drying, etc.)
- Procurement costs (sacks, packing, truck loading, transportation, etc.)
- Office in growing area
- Estimated credit default rate.

Companies should develop a budget for outgrowing operations based on projected production targets for 1-3 years (see illustrative budget below). Projected quantities can then be compared with projected costs to come up with a *per unit* cost for raw materials, which is then compared to a predetermined maximum *per unit* cost at which the outgrowing operation will remain viable. As stated earlier, the company must recognize that, when contrasted with existing methods of procurement from traders, etc., an outgrowing operation is unlikely to result in reduced raw materials costs—at least in the first few years.

COST FOR PILOT CHILI CONTRACT FARMING: 200 ACRES = 140 metric tons (700kg/acre)

	Number	Unit	Cost	Total Taka
High quality seed 3 kg per acre x 200 acres (on the basis of whole chili purchase)	600	kilo	300	180,000
Price paid to outgrowers (ripe, undried chili)	630,000	kilo	13	8,190,000
Commission for group leaders (includes loading and transport to warehouse)	630,000	kilo	0.8	504,000
Warehouse rental (with drying facilities)	630,000	kilo	0.25	157,500
Sun drying cost of ripe un-dried chili	630,000	kilo	0.25	157,500
Jute bags with polythene for dried chili (20 kg)	7000	bags	30	210,000
Packing costs (dried chili)	140,000	kilo	0.25	35,000
Truck loading cost (for transport to factory)	140,000	kilo	0.25	35,000
Transportation to factory (5 tons per truck)	28	truck	3000	84,000
Reimbursement of seed cost				-180,000
Contract Farming Coordinator	12	months	50,000	600,000
Field Staff (3 people x 6 months, includes transportation)	18	months	10,000	180,000
Small office in growing area	12	months	2,000	24,000
Training for staff / farmers			60,000	60,000
Total				10,237,000

Final cost per kilo dried chilies = 73.1

8) In what geographic areas will you conduct your outgrowing operations?

- Company should ensure that the targeted area has adequate infrastructure including
  - Utilities
  - Communication
  - Land availability
  - Availability of inputs (input suppliers, irrigation, etc.)
  - Other as specified
- The company needs to ensure that the enabling environment in the selected areas is conducive to outgrowing (government support, regulations, contract enforcement, etc.)
- Other factors include farmer familiarity with the crop, presence of financial institutions, soil fertility, climatic circumstances, infrastructure / accessibility to the area, openness of farmers to an outgrowing operation.

QUESTION GUIDE #2

HIRING STAFF FOR OUTGROWING OPERATIONS

How will you satisfy the staffing needs of your outgrowing operations?

Companies need to consider a variety of factors when hiring staff to manage their outgrowing operations. The following questions can help them think through their choices.

1) How many staff persons will you need?

Most outgrowing operations require a Company Coordinator and Field Agents and some may also require intermediary supervisors and/or an agricultural specialist.

The number of staff to hire will vary depending on the:

- Size of the outgrowing operation and the geographic area to cover
- Outgrowing model being used. A direct model typically requires more field agents than an indirect / intermediary model relying on lead farmers or other intermediaries
- Desired "field staff to outgrower" or "field staff to lead farmer" ratio. The optimal ratio depends on a variety of factors that include:
    - Outgrowing model being used
    - Type of crop—new commodities may require more field agents to monitor outgrower production activities than traditional crops
    - Margin - crops that generate a higher margin for the company (or that go into a finished product that generates a good margin) can allow a greater investment in both agronomic support and field agents
- Company financial capacity and its ability and willingness to invest over a long period of time.

2) Where will your outgrowing staff be based?

- Most companies prefer that their field staff be based as close to the outgrowing operations as possible.
- In many cases, companies want the coordinator to be based at the head office, often in the capital city. This is particularly appropriate if the outgrowing operations are close to the head office as it can facilitate close communication with company management (including finance and procurement departments). This does, however, require that the coordinator make frequent field visits.
- Other companies prefer their coordinators to be based closer to production areas, which facilitates oversight and supervision, but can result in communication gaps with company management. ***Note***: some qualified coordinator candidates may not be willing to live in a remote or rural area.

3) Will your field agents be from the targeted area or outside the targeted area?

- There are pros and cons—local field agents might know the farmers well and speak the local dialects, but they may also be subject local pressures and not as objective as agents from outside the area.

OUTGROWING COORDINATOR POSITION

4) What skills, knowledge and experience does the coordinator of your outgrowing operations need?

- Advise staff and outgrowers on crop production and post harvest practices
- Motivate outgrowers to achieve desired crop production standards
- Motivate and manage field agents
- Manage and coordinate input procurement logistics, distribution, production monitoring, outgrower training, post harvest handling and transportation
- Negotiate agreements with outgrowers / lead farmers
- Promote amicable relations with local businesses and government representatives
- Produce reports (using WORD and EXCEL) and communicate via email.

5) What will be the key duties and responsibilities of your coordinator?

- Coordinate all outgrowing operations for the company and supervise staff
- Coordinate with local government administrative and agricultural officials and key private sector actors—input providers, transporters, warehousing facilities, etc.
- Conduct regular field visits to contract farming areas and support field agents in carrying out their responsibilities
- Prepare outgrowing agreement modules and negotiate with outgrowers
- Participate in the development and delivery of training programs for staff and outgrowers
- Coordinate procurement and distribution of needed inputs to outgrowers, especially seeds
- Negotiate with local input suppliers to obtain preferential rates for company outgrowers
- Monitor crop production to ensure that recommended practices are followed
- Coordinate trials of new crop varieties and practices
- Coordinate procurement of outgrower crops
- Coordinate post harvest handling, processing, storage and transportation of products to the company factory or warehouse
- Oversee infrastructural developments such as land development, building construction and machinery installations within outgrowing areas.

FIELD AGENTS

6) What skills, knowledge and experience should your field agents have?

- Supervise and implement company outgrowing operations
- Advise outgrowers on proper agronomic practices
- Educate farmers on the advantages and benefits of participating in outgrowing operations
- Select good and resourceful farmers to serve as outgrowers
- Evaluate the appropriateness of land for targeted crops
- Conduct training / coaching sessions for outgrowers

- Manage demonstration and trial plots
- Coordinate harvesting, post harvest handling and processing of targeted crop(s)
- Produce simple reports.

7) What will be the key duties and responsibilities of your field agents?

- Maintain good relationships with local administrative and agricultural officials
- Maintain working relationship with local input suppliers
- Assist in evaluating suitable land and sites for outgrowing operations
- Assist in selecting good farmers to participate in the outgrowing scheme
- Assist in procuring and distributing crop inputs (if appropriate)
- Supervise crop production practices—land preparation, planting, irrigation, fertilizing, weeding, pest management, etc.
- Supervise and ensure best practices in crop harvesting and post harvest handling
- Provide periodic training / coaching to outgrowers
- Assist in organizing procurement operations with outgrowers (ensuring strict discipline, etc.)
- Help ensure that other companies are not purchasing from outgrowers and that side-selling is not taking place.

8) What will your staff remuneration package comprise?

- Some companies use performance-based packages to motivate field agents to exceed their targets. To balance company and individual interests, it is best to combine group-based rewards for all field agents with individual rewards for exceptional performance
- To some extent the remuneration package should depend on what is standard in the industry in a particular country as well as government regulations in this respect.

QUESTION GUIDE #3

SELECTING AND ENGAGING LEAD FARMERS

How will you select lead farmers in your outgrowing operations?

In an indirect or intermediary model of outgrowing, companies often need to choose *lead farmers* who can serve as liaisons with outgrowers. These lead farmers typically have a contract or agreement with the company to perform certain roles and functions.

1) What are your criteria for lead farmer selection? Create a list.

The company needs to focus on criteria that will help it to choose lead farmers who can best respond to their particular needs. Potential criteria include:

- A good reputation, the respect and trust of the community, and the ability to influence people and convince them to listen
- Honest, hard-working and sincere
- Enjoy working with farmers
- A commitment to the community (money alone does not work)
- Loyalty to the company and honesty with regard to financial information, dealings with outgrowers, etc.
- Sufficient means to travel and communicate with outgrowers prior to receiving fees / commission
- Time to devote to the outgrowers (even if involved in other business activities, work with NGOs, etc.)
- Willing to carry out required lead farmer tasks (visiting farmers, meetings, etc.)
- Familiarity with the targeted crop(s)
- Space for a procurement site (advantageous, but not mandatory)
- A willingness to listen to outgrowers and ask for their input / opinions
- Have basic education and literacy skills
- Be progressive and willing to adopt and adapt new technologies.

2) Describe your strategy / approach for selecting lead farmers.

- Ask community leaders / businesspeople to propose lead farmer candidates
- Ask farmers to suggest a lead farmer
- Develop shortlist of lead farmers to present to farmers in target area for their input
- Ask for referrals from the local area government agricultural services
- Encourage farmers to approach the company and offer themselves as lead farmers
- Receive recommendations from existing lead farmers (referral system)
- Identify and promote high performing farmers who already produce for the company to lead farmer status.

3) Describe how (or if) you plan to solicit support from government agricultural service agencies in selecting lead farmers. If considering this direction, it is important to understand:

- Soliciting input from government agricultural agencies in lead farmer selection can help orient companies towards good lead farmer candidates and help build relationships between the company and those agencies
- Once the company initiates its activities, however, it should not depend on the agencies for ongoing services and lead farmer identification
- In proposing lead farmers, agency representatives may take the company only to the areas they know—there could be others and the company should check with additional sources of information
- In general, companies should be careful—they may need the support of agencies initially, but do not want to become dependent on them!

4) What will be the lead farmer role in your outgrowing operation?

Lead farmer roles and functions may include:

- Assist with input distribution
- Monitor farmers
- Provide farmers with technical advice
- Disseminate company information to farmers
- Assist with organizing training activities and demonstration plots
- Identify outgrowers
- Help company to prepare and implement procurement operations (it is recommended that company procure directly from individual outgrowers, not lead farmers)
    - Set up collection point(s)
    - Initial quality assessment of outgrower production
    - Support procurement schedule development (crop timing, pick-up times, etc.)
    - Organize procurement transportation
    - Receive payment and distribute to farmers.

Even if the company uses an indirect outgrower model (with lead farmers), it is important that they maintain a level of direct relationships with individual outgrowers. This can include training / coaching sessions for all outgrowers, meetings with lead farmers and their group members, distribution of inputs to and tracking of credit with individual outgrowers, direct procurement from individual outgrowers, etc. Without these direct relationships outgrowing operations tend to have greater problems with quality, adherence to crop production advice, side-selling, etc.

5) Describe how you plan to remunerate lead farmers?

- Lead farmer compensation typically involves a fee or commission based on the volume of production that group members produce and sell to the company. While there are other ways to compensate them (e.g., fixed payments), this is the most common. Though their compensation may be minimal (given all they do), some lead farmers consider what they do a contribution to their community and to the farmers with whom they work
- Another form of compensation is participation in training events and exposure visits organized by the company

- Being the lead farmer for an established company may confer special status in the community and could be an incentive to take on the role.

However they compensate their lead farmers, it is important that companies offer appropriate incentives for the work they expect of them.

6) How would you deal with a lead farmer who does not perform as expected?

Sometimes a lead farmer does not work out and needs to be replaced. This can be a sensitive process, especially if he/she is well-known in the community and the company expects to need his/her support in future. Depending on the situation, here are a few suggestions on ways to replace a lead farmer:

- Ask the underperforming lead farmer to suggest two or three possible replacements
- Ask field agents to recommend lead farmer candidates for the next season
- Survey outgrowers in the group to find and appoint a replacement lead farmer
- Release the underperforming lead farmer and use the criteria in 1) above to find another.

QUESTION GUIDE #4

SELECTING OUTGROWERS

How will you select outgrowers?

Outgrower selection is integral to the success (or failure) of any outgrowing operation. A number of options for selecting outgrowers are available and the one chosen depends on the outgrower model the company uses.

1) **What criteria will you use to select outgrowers? Create a list.**
   - Own the land to avoid problems stemming from landlord / farmer disputes. If land is leased, documentation must be clearly written and understood by all parties
   - Be personally involved in growing the crop (i.e., be a real farmer)
   - Have existing knowledge of the crop
   - Land must have appropriate soil and sufficient water for the crop to be planted
   - Be able to repay loans they receive
   - Respect agreements and be trustworthy
   - Be able to implement advanced production practices (e.g., irrigation, etc.)
   - Be a good listener and willing to follow company field agent and/or lead farmer suggestions / directives
   - Have the minimum amount of land and production capacity to produce crop(s) the company designates and in the correct context
   - Have land that it is contiguous with that of other outgrowers (to facilitate monitoring, communication, equipment use, etc.)
   - Be able and willing to keep records
   - Be pro-active and willing to invest in improved production practices
   - Be able and willing to comply with company infrastructural requirements (adequate storage, drying, cooling facilities, etc.).

You may want to rank or group the criteria according to their importance for your company.

2) ***IF YOU ARE USING AN INDIRECT MODEL AND LEAD FARMERS*, describe the process lead farmers should follow when selecting outgrowers. List each step.**
   - Lead farmer can explain outgrowing operation modalities to farmer groups in their area
   - Lead farmer confirms that the outgrower meets the company's minimum criteria (as listed in Question 1)
   - Lead farmer selects outgrowers who will be loyal to them and listen to them.

3) ***IF YOU ARE USING AN INDIRECT MODEL AND LEAD FARMERS*, describe your role in, and process for, selecting outgrowers.**
   - Company can ask lead farmers to propose outgrowers who meet the company criteria and could be part of their group

- Company field agents and lead farmers can meet with potential outgrowers to present outgrowing operation procedures and conditions. Field agents can use these meetings to present themselves, their acreage, experience, etc.
- The field agent and lead farmer can agree on who will be an outgrower and visit outgrower plots together
- Company may meet with some outgrowers to make sure they understand the agreement with the lead farmer and ensure there is no confusion or disagreement.

4) *IF YOU ARE FOLLOWING A DIRECT OUTGROWING MODEL*, describe your role in selecting outgrowers. List each step.

- Identify geographic area(s)
- Ask field agents to identify potential outgrowers using several different methods—investigation, government agriculture services, referrals, meetings with farmers, farmer self-selection, identifying farmers who currently grow the crop, etc.
- Determine if an outgrower meets company criteria by 1) using the criteria in #1 above when interviewing farmers and 2) by visiting the plot to verify the information provided
- Before fully engaging farmers, establish, and inform them about, the benchmarks they would have to achieve if accepted as outgrowers
- For existing outgrowing operations, encourage producers to:
    - Present themselves to the company
    - Refer other good farmers.

5) *IF YOU PLAN TO INTERACT WITH AN INDEPENDENT FARMERS' GROUP OR ASSOCIATION*, describe the role of the farmers' group or association in your work with outgrowers.

The role of the intermediary farmers' group or association should be limited and may include:

- Sharing company information
- Helping to enforce compliance by members
- Taking on certain infrastructure investments
- Establishing collection points
- While it is preferable for the company to make payments directly to individual farmers in the group, the company may send a consolidated payment and an itemized list of what is due each farmer to the intermediaries for them to distribute to their members.

6) *IF YOU PLAN ON INTERACTING WITH AN INDEPENDENT FARMERS' GROUP OR ASSOCIATION*, describe the interactions you expect to have with individual farmer-members.

The company should interact extensively with individual farmers and not be overly dependent on the intermediary farmers' group or association. Direct company transactions with farmers may include:

- Training / coaching on company-specific topics for all outgrowers
- Monitoring every producer-member
- Calculating individual producer input requirements
- Monitoring credit transactions of each farmer
- Grading and purchasing every farmers' production.

Working with Independent Farmers' Groups

In Kenya, the East African Growers Group conducts outgrowing operations for fresh vegetables for export. As part of these operations it works with a limited number of independent *self-help groups* (SHG) of small-scale farmers who work together to satisfy the volume requirements for producing vegetables for EAGA. By law, the SHGs must have elected officials and be legally registered business entities. At the time of harvest, the SHGs appoint or hire a *grader* to grade each member's harvest. The SHG then puts the farmers' production into individual boxes labeled with his/her name and SHG. EAGA collects the boxes, conducts the final grading and sends a consolidated payment to the group account along with an itemized list of the payment due each member. In conducting the final grading and payment *by individual farmer* – EAGA helps the groups avoid management problems.

QUESTION GUIDE #5

COMMUNICATING WITH OUTGROWERS

How will you maintain close communication with outgrowers?

It is critically important for the company to maintain close communication with outgrowers so it can:

- Inform producers adequately and in a timely fashion about changes and issues such as new or additional buyer requirements, quality concerns, price fluctuations, etc.
- Identify and address sensitive issues that, if not addressed could jeopardize the scheme and relationships
- Establish trust between both parties and contribute to outgrower loyalty to the company.

1) What do you wish to communicate to outgrowers?

- Recommended (best) agronomic practices (as well as prohibited practices)
- Production targets and schedules
- Quality parameters
- Prices
- Procurement arrangements.

2) How will you communicate with the outgrowers?

- By engaging lead farmers (indirect model)
- Through regular meetings with outgrowers
- During contract negotiations
- By visiting and monitoring farms
- By organizing field days for demonstration purposes
- Training and coaching activities
- Other means, if necessary.

Things to consider:

- Field agent and lead farmer communication skills may be weak and the company should consider ways to improve these essential skills
- Outgrower and lead farmer literacy rates may be limited and the company should explore the use of visual aids such as pictures, drawings and exposure visits—seeing is believing!
- Lead farmers may filter or even distort information from farmers due either to a misunderstanding and/or an interest in presenting information differently to the company
- Lead farmers may not communicate effectively or honestly with outgrowers
- The frequency of communication is likely to depend on the crop calendar—during certain periods such as planting and harvesting, daily communication is critical while at other times weekly or even monthly communication is sufficient
- Information on prices and engaging outgrowers in establishing pricing mechanisms are critical and it is important to clearly communicate those mechanisms to all outgrowers.

3) How will you ensure that you have two-way communication with outgrowers?

- It is important to get direct feedback from outgrowers to assess satisfaction level, manage expectations, and ensure that they receive and properly understand important information from the company
- Companies should engage outgrowers directly to get their thoughts on the operations and develop mechanisms that ensure outgrowers can get important information to the company. Some companies have high-level managers (above field agents) who organize formal monthly meetings with selected outgrowers.
- Examples of ensuring two-way communication include: 1) periodic visits and meetings between field agents, lead farmers and outgrowers and 2) regular meetings between field agents and high-level company managers
- It can be challenging for lead farmers to maintain regular communication with their outgrowers—most don't have vehicles and their commissions are modest. Some techniques they use to overcome these shortcomings include:
    - Meeting / speaking with group members in marketplaces
    - Using bicycles to inform them of meetings
    - Choosing farmers in close proximity and on contiguous fields
    - Conducting occasional, but not regularly scheduled field visits
    - Soliciting questions, thoughts and ideas from outgrowers.

Ensuring Two-way Communication with Outgrowers: East Africa Growers

The primary means of communication between East Africa Growers (EAGA) and its outgrowers is through company field agents who coordinate, monitor and advise outgrowers. The primary goal is to assure that outgrowers are producing crops in compliance with the stringent requirements of European supermarket chains. However, some regional managers have taken additional steps to ensure that they remain fully apprised of outgrower issues and concerns.

For example, one manager organizes quarterly, informal meetings open to all outgrowers during which they are encouraged to pose questions and raise issues they feel are not being addressed. One regional manager noted that he would try to resolve issues immediately, sometimes phoning the company home office to check on a payment to an outgrower. These types of meetings also are useful occasions to explore possible changes in company policies by getting outgrower reactions and input on how best to improve pricing practices or input provision.

QUESTION GUIDE #6

PROVIDING TECHNICAL ASSISTANCE TO OUTGROWERS

What kind of technical assistance and training will you provide to your outgrowers?

Along with good quality seeds, outgrowers tend to value company technical assistance (TA) more than anything else. This assistance can include training / coaching sessions, field-based technical advice and demonstrations. Technical assistance helps outgrowers produce according to company specifications and realize yields and quality that benefit both outgrower and company. Technical assistance also can increase outgrower productivity; make company operations more cost effective; and improve farmer profitability, all of which builds mutual trust and loyalty. TA also encourages and motivates outgrowers.

The following questions can assist the company to determine the types of TA to provide outgrowers.

FIELD-BASED TECHNICAL SUPPORT (EXTENSION)

1) **What are field agent tasks and objectives when providing technical advice and extension services to outgrowers during field visits?**
   - Give instant, on-the-spot advice
   - Respond quickly to crop disease
   - Answer specific questions and concerns
   - Monitor the correct application of and adherence to prescribed production packages
   - Plan production schedules and progress towards harvest
   - Plan for procurement
   - Provide farmers with feedback on rejections, poor production, etc.
   - Advise on post-harvest practices (drying, storage, etc.)
   - Provide farmers with written prescriptions for the necessary chemicals that they can take to input suppliers
   - Take digital pictures and share with experts (including international experts).

Company field agents can use outgrower record books to monitor the technical information provided to farmers. These books become part of the management information system (see *Question Guide #14*—**MANAGEMENT INFORMATION SYSTEMS**) that the company uses to track outgrower performance, review recommendations, etc.

TRAINING / COACHING

2) **What topics and activities will you cover in outgrower training / coaching sessions?**
   - Recommended agronomic practices
   - Post-harvest issues
   - Issues related to outgrowing operations, planting schedules, etc.
   - Distribution of seeds or other inputs

- Introductions to higher level people in the company
- Expert assistance in input supply, production and financial services by specialists in those and other relevant areas
- Past season results and adjusting practices for the upcoming season
- Discussion on procurement plans.

3) How will you develop training / coaching session content?

- The company training / coaching team can develop a training module or session plan that details the session approach and content and ensures the same message is delivered during multiple sessions with different trainers
- Experience shows that training programs including practical field visits provide better learning opportunities for outgrowers than those limited to classroom learning.

4) Who will be part of your training / coaching team?

- Company field staff
- Lead farmers
- Expert farmers, recruited as trainers, who have the following qualifications:
    - Extensive experience growing the targeted crop
    - Basic education
    - Good communication skills and speaking voice
    - Sufficient time to devote to coaching
    - Self-confidence
- Selected resource people.

5) Where and when will you organize outgrower training / coaching sessions?

- There are advantages to arranging training sites near demonstration plots to facilitate field demonstrations
- They should fit within the crop calendar (before planting, harvesting, etc.)
- Common options include:
    - Three sessions—one prior to planting, one during the growing season, and the last before harvesting
    - Two sessions—one prior to planting and the other before harvesting.

6) How can you make your training / coaching sessions cost effective?

- Engage input suppliers, and other service providers who have a commercial interest in contributing to the training
- Include local *expert farmers* on the training team; outgrowers can relate to them and they are less expensive than high level resource persons
- Limit duration and use a low-cost training site
- There is a trade-off between larger and smaller groups—large groups may be more cost effective, but small groups offer better learning opportunities.

7) **How will you develop your training / coaching team capacity?**
   - Organize a training of trainers (TOT) workshop for the training / coaching teams to:
     - Make sure that trainers are familiar with the training modules (including all technical issues)
     - Introduce adult learning methodologies
     - Allow them to practice the training before giving it to farmers
   - Invite expert farmer candidates to the TOT, evaluate them and select the best ones.

8) **How can you motivate field agents to provide training and technical support to outgrowers?**
   - Provide professional development opportunities such as training, exposure visits, etc
   - Offer awards and recognition for good work
   - Develop performance-based remuneration packages to improve their commitment to and the effectiveness of their technical support.

9) **What techniques can you use to promote good production practices and motivate outgrowers?**
   - Guided visits for outgrowers to selected farmers' fields to observe good practices
   - Visits by company managers to farmers' fields lets managers see reality on the ground and motivates farmers by making them feel part of and valued by the company
   - Visits to farmers by company buyers also can motivate the outgrowers
   - Visits by outgrowers to company factories and offices
   - Recognition such as *Best Outgrower of the Year*, *Best Lead Farmer of the Year*, etc.

MULTI-FLOWER FARMER EXTENSION

Multi-Flower Ltd conducts outgrowing operations with hundreds of small-scale producers for flower seed production. Their hands-on, professional extension services contribute a good deal to the success of the scheme, and, the considerable support and coaching that farmers receive from field agents plays a big role in helping them achieve their contractual outputs. The fact that field agent payment is partly results-based contributes to their high level of commitment and ensures they do their best to help farmers in their area achieve their targets. Doing so can double their salaries through the bonuses.

QUESTION GUIDE #7

PROVIDING CREDIT TO OUTGROWERS

Will you provide credit to outgrowers?

Companies engaged in outgrowing operations frequently need to provide credit to their outgrowers. The credit can include one or a combination of: 1) seed, 2) a full package of inputs or 3) cash. The amount of credit extended to farmers and the mechanisms used depend on a wide range of factors.

1) Is there sufficient rationale for you to consider providing outgrowers with credit? If so, what form and level of credit would you provide?

- If outgrowers need critical production inputs to produce a crop that satisfies company and end-market requirements, the company may be obligated to provide them on credit, particularly if the farmer cannot afford them
- If financial institutions or supplier companies are unwilling or unavailable to provide credit to farmers, the company may have to provide credit
- If the company provides some form of credit, it may convince farmers to participate in its outgrowing operation. Credit also can ensure loyalty to the company and reduce side-selling, though this is not always the case.
- If farmers are unable to pay labor costs required to harvest crops, the company may need to provide credit (in the form of an advance payment) to selected farmers prior to harvest. This form of credit typically is reserved for farmers that have a long-term relationship with the company.
- Some companies may want to begin their outgrowing operations with farmers who don't need credit and who can serve as models for others
- Companies must decide what amount and form of credit they will provide (seed on credit 100%, 50%, or less, fertilizer, pesticides, cash – how much to provide and when, a combination of approaches, etc. The following questions will help them decide.

2) Do risks outweigh benefits of providing credit to farmers?

Sources of risk include:

- If the company makes cash loans it cannot ensure the money is used as intended
- Providing inputs on credit can create a short-term incentive for some farmers to side-sell to another buyer who does not deduct the input cost from the price it pays the farmers
- Providing credit to farmers requires a large cash outlay that affects company cash flow
- If the company takes out a loan to finance credit to farmers, it can run into repayment difficulties if outgrowers default
- Monitoring credit to farmers can put company field agents in a difficult position when, in addition to providing technical support, they also must enforce loan repayments

- If farmers default and are excluded from outgrower operations, the company may have difficulty procuring sufficient production from remaining producers
- Providing credit may attract farmers who are interested only in the credit and not in performing well as an outgrower.

Additional considerations when weighing risks and benefits of providing credit to farmers

- Providing credit is less risky in closed marketing systems where there is no ready market for the crop outgrowers produce
- Outgrowers with an intermittent production schedule, such as short-term irrigated vegetables, have the advantage of regular harvests and payments, which reduces their overall need for financing
- Conversely, farmers producing and selling but once a year generally pose a higher risk of defaulting on loans
- Providing in-kind credit, as opposed to cash loans, usually poses less risk of default
- Convincing financial institutions or input suppliers to provide farmers with finance or production materials can spread or eliminate credit risks (see the next section on Mitigating Credit Risks).

Mitigating Credit Risks

3) Can outgrowers obtain credit directly from financial institutions (banks, micro-finance institutions, etc.)?

In some cases a financial institution may make direct loans to outgrowers based on their credit history and ongoing relationships with the bank. The chief advantage of this option is that the company is not exposed to any risk because the process is limited to the relationship between the financial institution and borrowing farmer. The challenges of this option include:

- Many financial institutions, especially microfinance institutions (MFIs), do not have lending products tailored to agricultural production calendars. However, the company can encourage financial institutions to develop appropriate lending products if it can:
    - Provide an attractive number of potential new clients, and
    - Act as a moral guarantor by assuring that its outgrowers are reliable suppliers.
- The need for physical collateral limits the client base of many financial institutions to borrowers with sufficient assets—a problem for many outgrowers. Some formal financial institutions are adopting lending practices that base specific loans on character assessment, spread risk over large numbers of similar borrowers and use group-lending practices that rely on peer pressure to minimize default rates.
- Where there are Village-Based Savings and Loan organizations (VBSLs), farmers who are members may be able to obtain production credit. Usually, though, VBSLs have only small amounts to lend as their liquidity is limited to its members savings. In addition, VBSL repayment terms typically do not correspond to agricultural production calendars.
- In general, it is difficult for small farmers to obtain an agricultural loan directly from a financial institution that usually lends only to large farmers who have collateral.

4) Are financial institutions and/or input supply companies willing to enter into a tripartite arrangement with your company?

- In tripartite arrangements, the company works out an agreement with a financial institution to provide financing directly to outgrowers. When it purchases product from outgrowers, the company sends the proceeds to the bank, which then deducts the loan and interest from the amount and deposits the balance in each farmer's account. This type of arrangement relieves the company of risks associated with providing credit to outgrowers and positively impacts its cash flow.
- To establish a tripartite arrangement a company must identify and short-list interested commercial banks, serious microfinance institutions or others and engage in discussions and negotiations to develop a model and financial product that meets everyone's needs. This can take time. The advantage for financial institutions is the opportunity to reach large numbers of agricultural producers with little risk and few administrative burdens.

Though the company does not provide a financial guarantee, the bank feels more secure in the fact that the farmer is producing for a reputable company and the company must send the sales proceeds to them first. As with all transactions that involve outgrowers, information and transparency are essential to maintain mutual trust. Below are examples of how such arrangements might function:

- Outgrowers must have an individual account with the participating financial institution. This can be a challenge for MFIs that do not take deposits or have individual accounts
- Once the financial institution agrees to lend to individual outgrowers the company provides a list of its outgrowers with information on suggested loan amounts based on production estimates
- The financial institution makes a loan to the farmer based on this information
- After purchasing outgrowers' products, the company sends the payments to the bank, which deducts the loan amount and interest and deposits the difference in each outgrower's account
- In some cases, the company arranges to have the bank wire a portion of the outgrower's loan directly into its own account for seeds it provides to the outgrower. This amount becomes part of the outgrower's loan with the bank
- The company can make a similar arrangement with input suppliers, sending a list of farmers and their input needs to an agreed upon supplier who then sends an invoice for these inputs to the bank. The bank pays the input supplier and adds the amount to each outgrower's loan and the supplier distributes the inputs to the outgrowers.

Other key points in successful tripartite arrangements between companies, banks and outgrowers include:

- Companies may be able to negotiate reduced interest rates, collateral obligations, etc. due to the economies of scale financial institutions often enjoy
    - The company helps reduce bank administrative costs by helping farmers with paperwork and establishing loan amounts based on acreage, which determines a farmer's production capacity

    - Lead farmers can help disseminate information and perform specific functions so the bank need not work with individual farmers on every transaction
- When available, crop insurance can help reduce risk for all parties in such arrangements
- Close collaboration between banks, the company, input suppliers, insurance agencies, farmers, etc. can make the entire process run smoothly.

Challenges to Initiating Tripartite Arrangements

- In many countries, financial institutions do not have branches in rural areas where outgrowing operations occur. Often the only banks in such areas are government-run and lack the capacity and sophistication to enter into tripartite agreements
- There is a perception among banks that agricultural lending to smallholder farmers is very risky
- The company needs to demonstrate how risks and administrative burdens can be reduced
- Outgrowers must have an individual account with the bank
- Success hinges on the relationship between companies and outgrowers—if this fails then the whole lending scheme also will fail
- If there is no crop insurance, banks may be reluctant to lend to farmers.

5) What form of credit will you provide outgrowers?

- Companies need to decide if they will provide:
    - Seed on credit (100%, 50%, less)
    - Fertilizer and pesticides
    - Cash (how much and when).

QUESTION GUIDE #8

ENSURING OUTGROWER ACCESS TO APPROPRIATE INPUTS, INCLUDING SEED

How will you ensure outgrowers have access to appropriate inputs (including seeds)?

Access to quality inputs for outgrowers is a critically important aspect of outgrowing operations as it helps ensure that they:

- Can grow the desired product varieties and quality
- Have the quality inputs needed to increase production
- Produce in conformance with buyer requirements, especially in high-end markets.

For many companies engaged in outgrowing operations, the sale and distribution of good quality inputs (particularly seed) to outgrowers is one of the most important elements of success. For this reason, the company must take particular care when designing its input distribution arrangements.

1) Will you need to facilitate access to inputs for your outgrowers?

There are several different reasons a company may have to help outgrowers access inputs:

- The required quantity and quality of inputs are unavailable in the areas where outgrowing operations are occurring
- Outgrowers cannot afford to purchase the required quantity and quality of inputs
- The need to ensure that outgrowers use specialized inputs as needed
- Often, particularly in high-end markets in which buyers have strict health and safety parameters such a minimum pesticide residue levels, companies need to work closely with their outgrowers to ensure conformance with buyer requirements. In such situations companies may need to:
    - Prescribe the minimum use of inputs (including seed) needed to attain the required quality and quantity of production while also keeping outgrower costs down. If producers resist, the company MUST convince them to use fewer inputs.
    - Identify and mandate the input source that outgrowers must use
    - Procure and distribute inputs directly to outgrowers, either with a discount for volume, for cash, or credit
    - Develop guidelines, pamphlets, technical manuals, etc. that describe the correct application of inputs for specific crops
    - Restrict the use of certain inputs by outgrowers
    - Establish and sometimes implement spraying schedules together with outgrowers
    - Import specific inputs on their own.
- Demonstrating the tangible benefits it is providing them can help the company build closer relationships and trust with outgrowers and reduce side-selling.

2) If you need to facilitate access to needed inputs, how will you do it?

- Purchase and sell to outgrowers
- Purchase and provide to outgrowers on credit
- Work with input suppliers to facilitate the sale of inputs to outgrowers
- Facilitate linkages between outgrowers and financial institutions for credit to purchase inputs (for more information, refer to both *Question Guide #7* and *Intervention Brief #7*—**CREDIT FOR OUTGROWERS**).

Questions the company must answer if it is distributing the inputs, whether requiring upfront payment or providing them on credit

3) Where will you get the inputs?

- Import inputs yourself
- Purchase from local input manufacturers or suppliers
- Produce your own inputs, particularly seed—in many cases companies should consider developing a seed multiplication program to ensure quality seed for their outgrowers (see *Question Guide #11*— **DEVELOPING A SEED PROGRAM**).

If a company purchases seed from third parties it should conduct due diligence—monitor the seed while it is kept in the warehouse / cold storage prior to season start, conduct pre-planting / sprouting tests, etc. It is advantageous to have more than one source of seed in case problems occur with a particular provider.

4) How will you manage the input distribution logistics?

- Establish a selling point—either a company warehouse or other site convenient to outgrowers where they can purchase the inputs
- Sell inputs to individual outgrowers during a pre-planting training / coaching session or preliminary meeting with them
- Develop a list of outgrowers with input amount – including credit if appropriate – for each and give it to the lead farmers. Outgrowers can pick up the inputs, often in the presence of a company agent, at a predetermined place, date and time or the lead farmer can be responsible for distributing them to each outgrower.

Note: Relying on lead farmers to manage the distribution of inputs (and credit) to outgrowers without company supervision is not recommended practice (see ***Question 9***, below for examples of potential problems in relying on lead farmers to distribute inputs).

5) What price will you charge outgrowers for inputs?

A number of different pricing strategies exist and the type of strategy a company chooses depends on its priorities. Pricing strategy types include:

- Add margin to cover the costs of other activities such as training or extension services
- Subsidize the cost to outgrowers to encourage use of inputs
- Charge the actual cost of inputs, including distribution.

6) How will you collect outgrower payment if you require it upfront?

Companies should consider how to minimize risks associated with receiving upfront payments from farmers. It usually is better not to rely on third party intermediaries (lead farmers, producer groups) to collect payments. Risk reduction strategies include:

- Utilize a single selling point, preferably a company warehouse or office
- Ensure a company representative is present at the time of payment
- Collect cash from individual outgrowers in advance and distribute inputs at a later, agreed-upon time.

7) How will you collect outgrower payments if you provide inputs on credit?

There are several payment options companies can use with outgrowers receiving inputs on credit. In general, it is best not to rely on lead farmers (or producer groups) to distribute inputs on credit or collect payments from individual outgrowers on behalf of the company—this can lead to a whole range of management problems. Options for collecting outgrower payments include:

- Deducting the total cost of inputs from the final price paid outgrowers at harvest in a pre-determined, mutually-agreed and transparent manner
- Partial payment by outgrowers upon delivery of the inputs with the balance, plus additional charges, if any, deducted from the final price paid at harvest.

8) When will you distribute the inputs?

Regardless of the payment scheme, the timing of input distribution is critical to ensure the correct use of them by outgrowers. Timing strategies include:

- Ensure that input distribution takes place early enough in the season to allow outgrowers to plant on time
- Input distribution during training / coaching events work if logistics are well planned. Otherwise it may detract from the event, particularly one that is time-constrained.

9) How can you minimize potential problems if you have to rely on lead farmers or producer groups to distribute inputs to outgrowers?

Some companies rely on lead farmers or producer group representatives to distribute inputs to individual outgrowers because logistics are easier and it helps reduce costs. Company field agents should be present during distribution by a third party to minimize problems such as:

- The distribution of inputs to non-designated persons
- Lead farmers trying to sell the inputs or replace them with others of lower quality
- Asking outgrowers to pay more than the price the company communicated to them and that they agreed to pay
- Logistical difficulties with recordkeeping and distribution.

An additional question to answer if the company relies on third party suppliers to sell inputs to outgrowers is:

10) What types of arrangements will you make with private suppliers to ensure your outgrowers have access to the necessary inputs?

Companies should establish links and arrangements with input suppliers; these are good for the suppliers' business when large numbers of outgrowers become customers. The level of supplier engagement with and investment in outgrowers depends largely on the nature of the crop and buyer and end-market requirements. A company may want to enter into a Memorandum of

Understanding (MOU) with selected input suppliers to support outgrowers with inputs, and technical assistance. These types of arrangements allow companies to:

- Work with existing input retailers and request that they carry and sell specific products directly to outgrowers or lead farmers
- Arrange with suppliers to offer discounts to outgrowers
- Persuade suppliers to allow lead farmers to become distribution agents who receive inputs at distributor prices and sell to outgrowers at market prices so farmers need not travel long distances to procure inputs or worry that those they buy are adulterated
- Encourage suppliers to expand their distribution systems to cover company outgrowing areas
- Convince suppliers to adapt inputs to outgrower needs—packaging, product distribution, etc.—or to develop custom *chemical kits* (see ***text box***)
- Encourage suppliers to engage in training activities, demonstration plots, trial plots, field days, etc. by using their products and providing training and TA to outgrowers and TOT to field agents
- Avoid providing inputs on credit and the associated risks of farmer side-selling and subsidization of competitors
- Collaborate with supplier(s) to lobby government to permit imports of critical inputs.

PepsiCo India

PepsiCo India, which conducts large-scale potato outgrowing operations, and the DuPont Chemical Company, which sells agricultural inputs, entered into an agreement stipulating that 1) DuPont would develop a chemical kit based on products and exact dosages that PepsiCo outgrowers needed and 2) DuPont would provide free training to PepsiCo field agents and outgrowers, protective clothing for outgrowers, and a power sprayer (and 3-year guarantee) for every 200 outgrowers.

QUESTION GUIDE #9

DETERMINING PRICE FOR OUTGROWER PRODUCE

How will you determine the pricing of produce you purchase from outgrowers?

Companies have a range of options to choose from when it comes to setting prices with outgrowers. Three of the most common pricing mechanisms are: 1) fixed prices, 2) market prices and 3) split prices. Under ***fixed pricing***, the company offers the outgrower a fixed price at the beginning of the season. Under ***spot market pricing***, the company agrees to pay the outgrower the prevailing market price (or slightly higher) at the time of purchase. Under ***split pricing***, the company pays an agreed upon *base price* at the time of purchase and makes a final payment once it on-sells or processes the product. However, companies usually use ***pricing formulas*** that combine elements of all three mechanisms to address the weaknesses of each.

1) Are you operating in a closed or open marketing system?

- Fixed pricing in open marketing systems (where ready markets exist for the crops outgrowers produce) are frequently problematic as outgrowers do not want to sell at agreed-upon prices when market prices go up (although they will insist that the company purchase at agreed-upon prices if market prices are lower). For this reason the spot market pricing system seems to be most suited for commodities that have many competing buyers.
- It is generally better to use a ***pricing formula*** than firm fixed prices, particularly in open marketing systems, in order to be able to respond swiftly to market changes.

2) What type of business are you in?

- Companies using outgrowing operations for seed production typically offer a higher than market price as crops produced for seeds are more valuable than those produced for consumption or processing. In these cases companies can use fixed prices as they are higher than what a producer could find on the open (commodity) market. Obviously, this is not the case if the seed market is competitive with many companies interested in the same seed
- The seed business generally also allows the company to invest more heavily in providing inputs and credit to farmers because: 1) the risk of side-selling is lower and 2) the company is making a greater margin on the sale of seeds which it can use to invest in its outgrowing operations.

3) What are the outgrower production costs?

- Companies should do an in-depth analysis of farmer production costs, preferably in a participatory manner, as a basis for establishing prices or pricing strategies. The analysis needs to be updated regularly to take into account changing input prices
- When establishing costs, the company should tell outgrowers that an increase in income is due primarily to improved productivity (resulting from company assistance with seed, inputs and technology transfer) – ***and not to higher prices***. This is a challenge because it

is difficult to change attitudes. However, if companies do not address the issue, outgrowers are likely to hold on to their bias toward higher prices.

4) How will you engage outgrowers in setting prices?

- Buyers have a tendency to set prices unilaterally. This makes farmers feel vulnerable and powerless and may negatively affect their commitment to any agreement with the buyer
- The best way to ensure mutual commitment to an agreement is to engage outgrowers' representatives in open and transparent price-level negotiations based on realistic production costs in which both parties share the benefits and risks of changing (world) market prices
- A committee of company and outgrower representatives who periodically check market prices in selected areas to determine the appropriate price can set spot market pricing.

5) How will you determine and adjust the price?

- To avoid discouraging outgrowers from participating in future operations, companies must offer a price that allows them to make an acceptable profit
- In situations where companies produce crops that sell at relatively low prices at the time of first harvest and at higher prices during following weeks, they might offer outgrowers a higher than market price at the time of first harvest. This strategy is unlikely to damage the company's bottom line in the medium-term and can help ensure that producers continue working with it over the long-term.
- Companies must realize and be willing to accept that a small price difference can convince farmers to break a contract even though they risk consequences such as the loss of inputs for the following season
- Companies must recognize that a contracted fixed price may or may not reflect the current market price; if it is higher, the company should match the price others offer and not expect outgrowers to fulfill their contractual obligations
- There needs to be a mechanism for identifying and dealing with changes in (world) market prices and how they impact local market prices.

Pricing – ITC India

Instead of a fixed, pre-determined price for the vegetables it procures from outgrowers, ITC follows a *dynamic market reference* pricing policy. Every evening ITC staff compiles prices from reference mandis (government mandated auction markets) and offers those to farmers at its collection centre the next morning. The farmer also is able to get market prices at their village farm gate. ITC deducts the packaging and transportation costs (10 percent), which farmers would have incurred if they had sold their produce directly in the mandis. Farmers still save a lot since they don't have to pay mandi tax, loading and unloading charges, and it saves their commute time. Farmer's net income increases by four to eight percent by selling their vegetables to ITC directly at the collection centre.

QUESTION GUIDE #10

PROCURING FROM OUTGROWERS

How will you arrange your procurement?

Well-managed procurement operations are critical to the success of an outgrowing operation. They require careful logistical and financial planning in order to succeed and the following questions can assist buyers with this crucial task.

1) **Where will you conduct the procurement with outgrowers?**
   - Collection points are an important element of the procurement system. If using an intermediary model, companies can engage lead farmers in establishing or facilitating these collection points.
   - To ensure trust and transparency during grading, weighing and payment, it is best if the lead farmer and group members are present at the procurement site
   - In the direct model, the company is likely to establish buying posts and it also may engage agents to manage them.

2) **How will you undertake your grading activities?**
   - The company must ensure that the outgrowers clearly understand all aspects of the grading system, including the process, the prices paid for particular grades, the standards applied for grading, etc. A transparent and well understood grading and weighing system (good scales, weighing techniques, etc.) will create good will and high morale amongst outgrowers.
   - If final grading and rejections need to be conducted at the company's warehouse or processing plant, the company must explain / demonstrate this process clearly to outgrowers to avoid suspicion.
   - The company must have feedback systems in place to inform outgrowers of problems and guide them on ways to improve their practices in future.
   - If the company delegates post-harvest functions, e.g. drying, sorting, cleaning, etc. to outgrowers, it allows them to add value to their crops and to increase their profits.

3) **Will you purchase or find a market for the outgrowers' second grade or rejected products?**
   - The company can increase outgrower loyalty and profitability if it can find an alternative market for, and purchase, lower-grade products that would otherwise be rejected
   - Companies sometimes find ways to sell, or to process and sell, second grade products on the local market.

4) **What cleaning and packing materials will you provide the outgrowers?**
   - In many cases it makes sense for the company to provide its outgrowers with sacks and packaging materials to improve the procurement process and assure better quality.
   - Provision of cleaning materials (sieves, etc.) to clean the crop is particularly relevant for high value commodities like seed and could be provided either to the outgrower or handled at the collection point.

5) How will you organize payments?

- It is preferable for the company to grade, purchase and make payments to ***individual*** outgrowers, even if they are part of a lead farmer's or an independent group. Purchasing in this way fosters greater trust and better relationships with group members
- The more quickly the company makes payments following procurement, the better. Delays can breed outgrower frustration and if they suspect payment be a delayed, they may be tempted to side-sell for immediate cash
- It is important for companies to work with their own finance department to make careful projections and ensure adequate cash flow at the time of procurement
- The company must make arrangements with local bank branches early on so they can plan to have sufficient liquidity to honor payments to outgrowers because:
    - It requires discussions and negotiations between the company and banks well in advance of the period when funds are needed
    - When using an indirect outgrowing model with lead farmers, the company can set up an account in that person's name. At the time of procurement, the company can give the lead farmer a check for the amount due to outgrowers in his group as well as a detailed list of each farmer and payments due. The lead farmer can then go to the bank (in some cases with group members and a company representative) to cash the check and distribute payment to each member
    - Companies should understand that local bank branches, particularly those that are government-owned, are often limited in the amount of cash they have available to pay large numbers of outgrowers at one time
    - It should be noted that emerging technologies allow companies to make payments to producers using mobile phone technology.

Arrangements with Local Banks in Bangladesh

As part of its outgrowing operations for peanuts and potatoes in a far northern rural area of Bangladesh, Bombay Sweets first attempted to help outgrowers establish their own bank accounts with local branches of government-operated banks, even going to the extent of taking their pictures and filling out applications for them. This proved unfeasible for several thousand farmers and Bombay Sweets decided to work through lead farmers and establish accounts for them. At the time of procurement, lead farmers and their groups arrived at the procurement center with their produce for grading and weighing and the company provided the lead farmers a copy of the list of all group members and the amount due each and wrote a check for the total due in his name. He then went to the bank, often with group members and a Bombay Sweets representative, to cash the check and distribute the proceeds. However, as outgrower numbers increased, company field agents had trouble accompanying each group and bank branches often had insufficient liquidity to honor checks. These problems meant that lead farmers and their groups had to return at a later date, often from long distances.

6) How will you organize transportation?

- The company must plan carefully to ensure adequate transportation at the time of procurement
- The company also needs to identify reliable transporters to load and transport in an appropriate way that does not damage the crop.

7) What records will you keep for your procurement operations?

- At the time of procurement it is important to label the bags with outgrower information for traceability
- In addition to the outgrower's name and personal identification number, the label should include information on the variety, volume and date of delivery.

8) Other Procurement Issues the Company Should Consider

- In many cases it is better for the company to encourage outgrowers not to use all of their land for outgrowing and to cultivate some of their own products to sell to other buyers (this varies depending on the crop, context, etc.)
- Procurement systems are critical as related transaction costs are usually transferred to outgrowers through deductions on the price the company pays them. Efficiency improvements are likely to have an immediate impact on the outgrowers.
- Since most post-harvest losses are a cause of poor handling, storage and transport, tackling these procurement-related issues can greatly improve returns for outgrowers.

ILLUSTRATIVE COMPANY PROCUREMENT LIST, BANGLADESH
PROCUREMENT SYSTEM MONITORING LIST

1) **Do you have a procurement schedule? Describe.**
   - How is the company assembling contract farmers' production?
   - What is the lead farmers' role in procurement?

2) **Do you have sufficient procurement materials (gunny bags, moisture meter, etc.) at hand?**

3) **Who is on the procurement team? Describe.**
   - Who has overall responsibility? What are the roles of all team members?
   - Are these permanent or temporary staffs?
   - How many staff carry out bagging, handling, etc.?
   - Who is supervising financial management?
   - Is the security staff adequate?

4) **What kind of bookkeeping system and documents are used?**
   - Describe and diagram forms / registers.
   - Describe if / how bags are tagged.

5) **How are payments organized?**
   - Are there arrangements with a local bank?
   - How many bank branches will be used? At what locations?
   - Who has signatory authority?
   - How is payment made to contract farmers? Provide specific steps / details.
   - Are there arrangements that ensure the availability of funds in accordance with the production schedule?

6) **How are the following operations being handled?**
   - Grading / testing of purchased products—what are the grading policies?
   - Weighing of products—what standards are used?

7) **How is the warehouse operation managed?**
   - Describe the inventory and storage system.
   - Describe all forms and registers.

8) **What are your arrangements for additional processing, e.g. drying, storage, etc.?**

9) **How is transportation organized? Describe.**
   - From farmer to procurement site?
   - From procurement site to warehouse?
   - From warehouse to company factory or export location?
   - Is there a transportation schedule?

QUESTION GUIDE #11

DEVELOPING A SEED PROGRAM

Should you develop a seed program as part of your outgrowing operations?

Gaining access to quality seed is one of the most important reasons and an excellent way to motivate farmers to participate in company outgrowing operations. Continued access to quality seed also convinces farmers to remain loyal to the company and refuse to jeopardize their access to good seed by side-selling their harvest.

1) What advantages (if any) would a seed program provide your company?

The advantages to developing a seed program for companies engaged in outgrowing operations program include:

- An assured source of good quality seed— seed provided by private seed companies or government agencies is often inconsistent in quality and availability, subject to price fluctuations, etc.
- Reduced dependency on third-party suppliers
- The ability to adapt, test or develop new seed varieties appropriate to their needs
- Greater control over the timely delivery of seeds to farmers to avoid delayed production
- An alternative commercial activity (selling seed) that helps the company cover its seed development program costs and subsidize its extension services to outgrowers
- High quality seeds are strong motivation for outgrowers to work with and remain loyal to the company (it may be best to develop a seed program before engaging farmers in outgrowing operations)
- Charging company outgrowers / lead farmers a premium price for quality seed can reduce the possibility of their selling it to others at a higher price.

2) Can you justify having your own seed program?

- A company needs to have a sufficient scale of operations to justify the expense / investment of developing its own seed program
- The company can justify its own seed program if it wants:
    - readily available high quality seeds
    - to create loyalty among outgrowers by providing consistently high quality seeds
    - to reduce dependence on seed suppliers
    - varieties adapted to its end-market requirements, etc.
- Companies should conduct a feasibility study / business plan that projects the costs, expected revenues and benefits of developing a seed program
- Given the amount of investment required, a company may first want to develop and test outgrowing operations before considering a seed program.

3) What kind of seed program do you want to develop?

There are several ways to develop a seed program:

- Sub contract to other seed companies—develop an agreement with one or more third-party seed companies to produce seeds for it
- Create its own seed from breeder or foundation seed
- Create seed through tissue culture, etc.

4) Where will you get your foundation or breeder seed?

- Consultations with agronomic experts, internet research, etc. can lead to possible sources of seed
- Buyers the company deals with may be able to obtain it abroad.

5) What investments will you need to make for your seed program?

- Investments vary widely depending on the crop and the type of seed program
- Companies should conduct a feasibility analysis before deciding whether or not to invest in developing a seed production program.

QUESTION GUIDE #12

DEVELOPING DEMONSTRATION PLOTS

How will you use demonstration plots in your outgrowing operation?

Demonstration plots are frequently used by companies to demonstrate both effective, modern agronomic practices to producers and the profitability and benefits of adopting the varieties and improved practices it recommends. Farmers who are reluctant to change their agronomic practices are more likely to pick them up after seeing demonstration plot results. Demonstration plots can lead to increased trust and stronger relationships between the company and its outgrowers and, if used effectively, they can improve farmer productivity—another plus for the company.

1) What are the objectives of having demonstration plots?

- Demonstrating production techniques that can increase productivity
- Showing farmers the proper way to handle and use inputs such as:
    - new seed varieties
    - fertilizers
    - pesticides
    - herbicides
- Motivating farmers to adopt improved practices and/or inputs for better yields and product quality.

2) What technical production practices and/or inputs will you use on demonstration plots?

- Production packages should be affordable and readily accessible, and outgrowers should be able to adopt the demonstrated practices / inputs quickly and easily
- Technical production practices / inputs used on demonstration plots should be practical and appropriate to the local setting. The company must ensure that practices / inputs correspond to local agronomic parameters (soil, climate, geography, etc.).

3) How many and what size demonstration plots will you have?

- It is better to have a few well-cared-for demonstration plots than it is to have many that are not properly tended and, therefore, unlikely to display good results
- Though it may seem ideal for each lead farmer to have a demonstration plot, it could be expensive for the company to set up and field agents might find them difficult to monitor
- Plots should be large enough to provide a good demonstration of techniques, inputs, etc. and small enough to manage easily.

4) Where will you locate demonstration plots?

- Demonstration plots should be in strategic, easily accessible, visible locations for outgrowers living in the area
- Locating demonstration plots near areas where the company organizes outgrower training / coaching sessions is an advantage.

5) What is the company's role in managing demonstration plots?

Important considerations:

- It is better for a company to be involved in managing demonstration plots—leaving management entirely to farmers could lead to substandard results
- The company should assign a field agent to monitor the plots and guide farmers
- The company should have a checklist for the preparation and management of demonstration plots.

The role of the company in managing demonstration plots may include:

- Selecting experienced farmers with suitable land and location
- Selecting the demonstration plot site
- Testing the soil when possible
- Collecting and distributing inputs such as seeds, fertilizers and pesticides
- Assessing seed quality through purity, germination and vigor tests
- Treating seeds before planting
- Preparing a detailed work schedule, monitoring the plot at regular intervals and providing guidance and supervision to ensure:
    - Proper land preparation—plowing, laddering, fertilizer dosing, soil moisture, etc.
    - Sowing seeds at the appropriate time
    - Transplanting seedlings at the proper age
    - Employing crop management practices such as mulching, fertilizer application, thinning, weeding, rouging, etc.
    - Monitoring for insects and diseases and the application of control measures such as appropriate pesticides and non-chemical / integrated pest management (IPM) alternatives if available
    - Harvesting demo plot crop(s) separately from those in other plots at appropriate stages and using proper methods
    - Post-harvest operations such as threshing, cleaning, drying, sorting, grading, packaging, storing, etc.
    - Weighing and recording crop yield after completing post-harvest processing (both sorted / graded and ungraded / unsorted)
    - Recording data in the approved format.

6) What is the role of outgrowers selected to farm demonstration plots? It is important that:

- The most qualified and trustworthy farmers should manage the demonstration plots—companies should not automatically select lead farmers as plot managers.

Possible roles for demonstration plot farmers:

- Assisting the company select suitable land
- Preparing the land according to company directives
- Timely and proper sowing of seeds as advised by the company
- Following crop management practices such as mulching, fertilizer application, thinning, weeding, rouging, irrigation etc. per company advisories

- Visiting the demo plot regularly and advising the company of any problems
- Adopting proper, company-directed pest control measures
- Harvesting, threshing, cleaning sorting, grading and drying crops as directed by the company
- Assist company to record data.

7) How will you compensate the farmer cultivating the demonstration plot?

Some companies engage an expert farmer, provide all the inputs and agree that the farmer can keep the harvest in return for maintaining and opening up the plot for outgrower field days. The company may consider contributing labor and irrigation costs up to harvest (weeding, mulching, etc.) to ensure they are done correctly.

8) How will you use the demonstration plot to motivate farmers to adopt improved production practices?

- Prepare sign boards with specific information and arrange to display them at the demonstration plot site
- Organize formal *field days* at demonstration plots and invite outgrowers and neighboring farmers to observe production and harvesting techniques
- Use demonstration plots in conjunction with other training / coaching activities for outgrowers
- Keep track of input / output data and share analysis results with farmers
- Organize and conduct guided visits to the plot at strategic points during soil preparation, planting, growing and harvesting.

QUESTION GUIDE #13

DEVELOPING TRIAL PLOTS

How will you use trial plots in your outgrowing operations?

Companies use trial plots *to experiment with new varieties and production methodologies*. Trial plots differ from demonstration plots, which companies use to show outgrowers how to carry out a proven practice it wants them to emulate. If the varieties and production methods grown and used on trial plots are successful, companies may show them to farmers. Companies also use trial plots to conduct multi-location trials of new varieties in conformance with government regulations that require they be tested before being *released* throughout the country.

1) What is the purpose of your trial plot?

- Companies use trial plots for a variety of reasons including testing new seeds in local climatic conditions, new production methods (seed versus transplanting, etc.), flood versus drip irrigation, spacing, multi-location trials, and the like
- Companies need to make sure that chosen varieties and technologies under experimentation are appropriate to the local climate, context and realities.

2) Who will manage your trial plot?

The company may choose either a participatory trial managed by local farmers or a company-managed trial. There are arguments for either choice, depending on whether the company has the land, qualified staff, etc. In either case, the company needs to be very involved in managing and monitoring the trial plot—much more so than it does with demonstration plots.

3) **What should be the role of the farmer responsible for cultivating the trial plot? (***case of a participatory trial in which a farmer takes an active role)*

- The farmer must follow strict company protocols regarding trial objectives and purpose
- The farmer should help the company keep track of trial results
- The agreement with the farmer must state that the farmer will provide or sell the harvest to the company, which should be prepared to compensate the farmer for lost production.
- If the company contracts with a local farmer to use his/her field, it must provide all inputs, labor costs and other expenses to ensure quality
- Farmer involvement can include selecting and preparing land, sowing seeds, applying company-developed production packages, visiting the field regularly, reporting problems to the field agent, taking preventive measures to protect against disease, harvesting / cleaning / storing the crop, keeping track of the register, etc.

4) What information will you collect and what format will you use to record the results of the trial plot?

(See **ILLUSTRATIVE FORMAT FOR RECORDING DATA**, below)

5) How will field agents support and manage the trial plot?

- The company should be actively involved in managing the trial plots (preferably with hired expertise on its own or leased land) to ensure that results are accurate.
- The company also must ensure that staff have clear instructions and correctly monitor the trial plot—otherwise it is not worth the investment.

6) How will you choose the trial plot area?

- Companies should take care when choosing land for trial plots, ensuring that soil and conditions are both suitable for and similar to the projected outgrowing operation areas
- Trial plots should be located within easy access of field agents to facilitate visits
- The selected area should be close to an irrigation source.

7) How many trial plots will you have and what size will they be?

- It is better to have a few well-cared-for trial plots than it is to have many that are not properly tended and, therefore, unlikely to display good results
- Trial plots should be large enough to provide useful trials, but small enough to be easily managed.

8) What is your work plan for establishing trial plot(s)?

- Illustrative activities include site and farmer selection, soil testing, input collection / distribution, seed quality assessment, seed treatment, land preparation, seed planting, sign board preparation, crop husbandry practices (mulching, fertilizer application, thinning, weeding, rouging, etc), harvesting, cleaning, drying, sorting, packaging, storage, etc.

ILLUSTRATIVE FORMAT FOR RECORDING DATA WHEN TESTING THE PERFORMANCE OF FOUR NEW SEED VARIETIES

Company Name:
Crop:
Date of sowing/transplanting:

Farmer Name:
Variety:
Date of harvest

1st:
2nd:
3rd:

Location:
Plot size:

Variety Name	Germination		DF at 50 %	DM (at 80-100 %)	No. of Pods / Plant	Disease Infestation (%)			Insect Infestation (%)			Plot Yield (kg)			Yield / Acre (kg)			
	No. of days	%				1st	2nd	3rd	1st	2nd	3rd	1st	2nd	3rd	1st	2nd	3rd	Total
Variety 1																		
Variety 2																		
Variety 3																		
Variety 4																		
……																		
Total																		

DF=Days to flower
DM=Days to maturity
Special notes (if any)
Note: Preferred size of plot should be 10'X10' per variety

QUESTION GUIDE #14

DEVELOPING MANAGEMENT INFORMATION SYSTEMS

What kind management information system do you need for the successful operation of your outgrowing operations?

Outgrowing operations require an appropriate management information system (MIS), one which includes tools and processes for record keeping, monitoring and communication. Companies should develop (or purchase) an MIS system based on the essential information they need. They should resist developing or buying a system that is too complicated or provides information they do not really need. The following questions can help companies to think through, research and develop strategies for collecting the necessary data and information.

1) What type of data and information will you need to manage your outgrowing operations?

It is important to think about what aspects of your outgrowing operations you will need to collect data and information about. Possible aspects include:

- Outgrowers
- Lead farmers
- Input distribution
- Procurement
- Company staff and field agent activities
- Outgrower productivity
- Other needed to comply with buyer requirements, industry standards, etc.

2) Who will use the data and information collected?

It is important to think about who is going to use the information you collect. This will help you decide the type of systems you need to develop, collate and analyze the data. ***Note***: there may be multiple uses for and users of the same data / information, including:

- Field agents
- Field management
- Company management
- Buyers
- Regulators
- Outgrowers.

3) What type of data and information on individual outgrowers do you need?

- Name and contact details
- Location (record GPS if possible)
- Acreage under cultivation
- Types of crops produced for the company
- Inputs received

- Inputs used
- Other types of crops produced
- Planting and harvesting dates (for planning purposes)
- Other comments.

4) **What type of data and information do you need on lead farmers (**if using an intermediary model**)?**
   - Lead farmer name and contact information
   - Names of all outgrowers in their group
   - Allocated area for each outgrower in their group
   - Projected production
   - Actual quantity collected
   - Activities the lead farmers conduct
   - Lead farmer performance in complying with company rules and supporting outgrowers
   - Records of inputs lead farmers receive and distribute to each outgrower.

5) **What type of data and information do you need for input distribution?**
   - Input types and quantities distributed or sold to each outgrower
   - Dates distributed and utilized by outgrowers
   - Cost of inputs (especially important if inputs are supplied on credit)
   - Repayment (if distributed on credit).

6) **What type of data and information do you need for your procurement operations?**
   - Dates purchased
   - Place of procurement
   - Quality and quantity of produce purchased from each outgrower
   - Names of individual outgrowers
   - Rate paid per kilogram
   - Outstanding loans reimbursed
   - Payments made to outgrowers
   - Outgrowers' signatures
   - Related costs (if any)
     - Shipping costs to warehouse or retail location
     - Commissions paid
     - Labor costs
     - Storage costs.

7) **What type of data and information do you need to measure outgrower productivity?**
   - Quantity of desired quality product each outgrower produces per cultivated acre
   - Quantity of inputs (if any) provided to the outgrower
   - Projected production versus actual production
   - Performance evaluation ranking.

8) What type of data and information do you need to monitor field agent activities?

- Outgrowing areas visited
- Number of visits to individual outgrowers
- Specific problems raised by individual outgrowers
    - Data detailing the received response or action
- Planned follow-up visits
- Trainings provided and participant lists
- Demonstration activities performed
- Signatures of field agents and field supervisors.

9) What systems will you use to collect, manage and process your data and information (computer applications, software, spreadsheets, manual registers, etc.)?

- Register / account books
- Receipts (for both company and outgrowers)
- Packaging labels
- Computerized documents, spreadsheets, databases, etc.
- Geographic Information Systems (GIS)
- Barcodes
- Digital pictures.

Note: new technologies can be expensive and are often unnecessary to meet specific company needs.

II. General Lessons Learned—The Company Perspective

This section presents the company perspective on lessons learned about managing an outgrowing operation. The points are drawn from existing companies as well as technical specialists with a broad range of experience.[4]

1) Make sure that outgrowing is appropriate to company needs

Companies engage in outgrowing operations for a number of reasons, all linked to improving their competitiveness. These reasons include:

- Diversifying their supply sources to mitigate risk and increase production
- Developing quality products and the flexibility to respond to market demands
- Allowing them to focus more on processing and marketing, rather than production.

Despite these advantages and given the investment and long-term commitment needed to make outgrowing successful, companies should not take the decision lightly and need to weigh the potential risks and rewards very carefully. Risks can include:

- Losing their investment and unintentionally subsidizing competitors due to side-selling by the outgrowers they supported with inputs and technical assistance
- Damaging credibility with buyers if outgrowing does not succeed and the company cannot meet orders fully and/or in a timely fashion
- Paying higher costs for raw materials, at least during the first few years, than they did when they bought them on the open market.

2) The company's end-market buyers should have a good understanding of the realities and challenges associated with outgrowing operations

It is important that a company's buyers appreciate the realities and challenges that outgrowing operations can present and respect what the company is doing as it works to upgrade the skills of participating farmers. Having a better understanding of problems that may arise can convince buyers to be flexible with regard to delivery and price in specific situations and create the loyalty and trust that result in longer term relationships.

3) There must be strong demand for the company's final product to justify an investment in outgrowing operations and ensure success

Companies must have, or be very confident of achieving, strong end-market demand for their products before investing in an outgrowing operation. Contract farming requires substantial investment and a company should not find itself unable to sell its products. Such a situation would result in losses for the company and seriously undermine its relationship with outgrowers if it decreases or suspends its purchases.

[4] Some of these points are drawn from *Contract Farming in Malawi,* Kadale Consultants, Jason Agar and Peter Chiligo, August 2008

4) Companies need to be dynamic, flexible and open to change

Companies engaged in outgrowing operations must remain flexible in order to cope with 1) market volatility and changing market requirements; 2) increased competition from new entrants and; 3) changing production factors (input prices, soil conditions, water availability, etc.).

5) Outgrowing operations must be cost effective (extension, staffing, costs, etc.)

Companies must make a substantial investment in outgrowing operations if they are to be successful. However, if costs are excessive company management may not be willing to continue and it is important that operations be as cost effective as possible.

6) Seeing is believing

Farmers tend to be conservative and change the way they work only after they see improved yields, more efficient practices, and increased incomes. Companies therefore need to prioritize practical demonstrations and follow through on their promises and commitments to outgrowers.

7) Companies must provide practical, cost effective training and support to outgrowers

Company training and support to outgrowers has many advantages, including:

- Helping the company meet its end-market and volume requirements
- Reducing the risk of loss for both the company and outgrowers
- Increasing farmer productivity and profitability thus ensuring their continued participation and loyalty
- Demonstrating company commitment that fosters trust and forges strong relationships with outgrowers
- Allowing outgrowers to respond to different micro-climates and soil conditions and respond quickly to pests and crop disease.

8) Companies need an assured source of quality seed to sell / distribute to outgrowers

Good quality seed is an essential element of outgrowing operations because it:

- Helps ensure both higher productivity, yields and income for farmers and their loyalty to the company
- Helps promote economies of scale for the company by reducing the number of farmers needed to produce targeted quantities
- Enables the company to produce the product size, quality and characteristics necessary to meet end-market requirements.

For these reasons it is frequently in the interest of companies to develop their own seed programs. Alternatively, they can develop relationships with reputable seed companies to ensure availability.

9) Companies should have well organized and dependable logistics and technical support

Companies need to prove their reliability and credibility with farmers by following through on the plans and commitments they make. This makes the company a *preferred buyer* for farmers, creates loyalty and results in less side-selling and better cooperation.

10) The company should make a careful assessment of the pros and cons of providing credit to farmers in outgrowing operations

There are many reasons companies extend credit to their outgrowers, but there are many risks involved, especially in an open market system where outgrowers can side-sell to other buyers. If a company extends credit and farmers do not repay their loans, it can jeopardize their entire operation. Companies must carefully assess the pros and cons of providing credit and determine the optimum strategy for its particular circumstances. If it provides high quality seed that improves outgrower productivity, it may feel comfortable providing seed on credit to farmers who want it in subsequent seasons and who will therefore make every effort to repay a loan. Other companies might prefer to provide a comprehensive package that includes inputs and cash or they may be able to facilitate the provision of credit through input suppliers and/or local financial institutions.

11) Productivity gains outweigh price gains

The biggest benefit to outgrowers usually results from increased productivity and production levels, not higher prices. Such gains can result when a company provides outgrowers with technical assistance and access to improved inputs, particularly seed. Promoting higher outgrower productivity enables companies to procure more product from the same number of outgrowers, a very advantageous situation for both farmer and company. To quote a PepsiCo representative “unless we can increase the productivity of our outgrowers by at least 30%, then the outgrowing operations will not work for us”.

12) Need for good lines of communication between the company and outgrowers

As in any relationship, communication is critical to maintain trust and understanding and avoid unrealistic expectations. Companies must communicate with outgrowers regularly on operations and schedules for seed and input distribution, planting, procurement, etc. and they should be ready to respond to farmers’ concerns and issues. Companies also need to ensure that outgrowers, and lead farmers if they are involved, clearly understand their agreements with the company to avoid misunderstandings and confusion during outgrowing operations.

13) Company should have a high level of accountability and transparency with regard to measures, weighing, company policies, etc.

It is critically important for companies to be honest, open and transparent with outgrowers, especially during procurement operations. This can reduce areas of conflict, promote trust and increase the likelihood that outgrowers respect their contract conditions.

14) While it is difficult to legally enforce agreements with outgrowers, the Company should be strict in enforcing contract requirements

In most cases, companies do not expect their contracts with outgrowers to be legally enforced. It is both impractical and politically risky to seek to enforce contracts signed by hundreds of outgrowers who may not even be traceable through the legal system. It is crucially important, however, for companies to send a clear message when outgrowers or lead farmers do not comply with agreed upon operations—selling to other companies, diverting seed for personal use, not applying agreed upon production packages, etc. Unless the other outgrowers see that there are serious consequences to this behavior it is unlikely to stop, which ultimately can result in the failure of the outgrowing operation. Strict enforcement of rules at the outset can also result in reduced need over time for extensive monitoring.

15) Companies should look to establish long-term, mutually beneficial and growth-oriented relationships with their outgrowers

It is in a company's best interest to establish strong, mutually beneficial relationships with its outgrowers. Both parties to an outgrowing agreement need to be happy in order for it to succeed and there are many ways companies can promote such relationships including:

- Providing year-round market access to farmers' products, if possible
- Working with outgrowers to adopt optimal crop rotation schedules that are profitable for farmers and meet the company's needs
- Assessing farmers costs of production to ensure they are making and increasing their profits as part of their participation in the outgrowing operation
- Helping ensure that farmers have a market for their rejected products
- Encouraging farmers when possible to take on value-added activities, e.g. drying, sorting, cleaning, storage, etc. to earn additional income
- Allowing farmers to sell non-contracted production to other markets.

These kinds of activities can make outgrowing operations more interesting and profitable for farmers and lead them to become more loyal and committed to the company. It also can stimulate more ambitious, business-minded farmers and keep them as producers. Finally, activities such as working year round with outgrowers can make company extension staff more cost effective.

16) Top management should be actively engaged in the outgrowing operation

It is important that, with large companies in particular, high-level management (including the owner and/or directors) be both involved in the initial decision to establish an outgrowing operation and believe in the business model. They should engage in strategic decision-making and understand the long-term nature of the investment and the fact that they may not realize the full benefit of their investment for a few seasons. An outgrowing operation is a serious, long-term investment that has substantial investment costs and, often, some start-up problems. The involvement of high-level managers is important because they can help:

- Avoid or address inter-departmental conflicts, e.g those between procurement and outgrowing departments
- Ensure that proper management systems are developed and implemented
- Ensure that outgrowing operation expenditures are approved in a timely manner

It is essential that the high-level managers communicate their commitment and reasons for engaging in outgrowing operations to their mid-level managers.

III. Suggestions on How to Address Side-Selling

Side-selling is perhaps the greatest threat to successful outgrowing operations. When a company invests resources in its outgrowers, it expects to be able buy their produce. If an outgrower has received technical assistance and inputs and then sells the produce outside of the contract to a competing company or trader, then the support the contracting company provided is a wasted investment and, even worse, acts as a subsidy for competitors who reap the benefits. If this happens on a wide scale, the company may see no reason to continue investing in production and could abandon its outgrowing operation along with any support it provides outgrowers.

The following is a list of suggestions compiled during interviews with technical experts and firms with successful outgrowing operations that can help companies avoid side-selling by outgrowers.

1) Use flexible formulas to develop prices

Fixed pricing in open marketing systems where ready markets exist for crops outgrowers produce are often problematic. Though outgrowers do not want to sell at agreed-upon prices when market prices go up, they usually insist that the company purchase at the agreed price if market prices go down!

Competing companies know it is easy to convince outgrowers to break their contracts by offering a small increase in price, even though farmers risk consequences such as losing inputs the next season. Companies need to recognize that a fixed price may or may not reflect the market and they must be ready to respond to changes in the local market by matching those prices and not expecting farmers to fulfill their obligations. To avoid side-selling in these situations, it is preferable to use a pricing formula that can respond to market changes (see *Question Guide #9* **PRICING**).

2) Engage outgrowers in determining prices and pricing formulas

The best way to ensure mutual commitment to the agreement is to hold open and transparent price-level negotiations based on realistic production costs with selected outgrowers and/or lead farmers in which both sides accept the benefits and risks of changing market prices.

3) Ensure that outgrowers receive prompt payment

Farmers frequently face cash flow problems at the end of the production season, just before the crops are harvested. Companies need to move quickly to announce prices and begin buying if they are to secure crops and reduce side selling. Cash payments or a system that allows outgrowers to receive cash quickly are crucial. Providing advances to reliable outgrowers who have been working with the company for a number of years can be another effective way to reduce side-selling. This approach benefits those who receive the advance payment and it sends a signal to other outgrowers that reliability is rewarded.

4) Work with local government to develop concession programs to protect larger investments

Some countries have *concession* programs that encourage companies to make large capital investments (such as cotton gins) and a corresponding investment in local farmers through extension, input provision, etc. In this system, the government allocates a geographic area to a company and prohibits other companies from setting up processing facilities in that area for a certain period of time. This mitigates the risk of side-selling for these companies and encourages them to invest in outgrowing operations.

5) Establish codes of conduct with other companies

As government regulations are usually unable to control side-selling, companies conducting outgrowing operations with the same crops can establish a code of conduct in which they agree not to purchase produce from each others' outgrowers.

6) Establish a third-party entity to review and try to settle disputes, including side-selling, related to outgrowing operations

Companies, in consultation with their outgrowers, sometimes establish third party entities to resolve side-selling and other disputes that may arise in the outgrowing operation. These entities might be composed of respected individuals or authorities in local communities.

7) Invest in a good relationship with outgrowers

Generating goodwill helps to reduce the incidence of side-selling. Following are examples of company-sponsored activities that can generate a great deal of goodwill:

- Educational grants or transportation for outgrowers' children
- Availability of emergency funds for health or funeral costs
- Access to entertainment events such as cinema, soccer, etc.
- Assisting outgrowers with subsistence crops that are not part of the outgrowing operation
- Access to fee-based post-harvest storage or processing services for crops not included in the outgrowing operation.

8) Regular contact and good communication with outgrowers

Regular and open communication enables both company and outgrowers to raise and deal with sensitive issues such as prices that, if not addressed in a timely manner, could jeopardize both relationships and outgrowing operation. Good communication also enables the company to inform outgrowers about issues such as new or additional buyer requirements, quality concerns, price fluctuations, etc. Such communication can help to establish trust between both parties and contribute to the outgrowers' sense of loyalty to the company.

9) Do your best to purchase outgrowers' second-grade products

Usually, companies only want to purchase high quality produce that conforms to end-market requirements. However, in farming there is always second grade product and, instead of returning rejected produce to outgrowers for them to sell, a better option is for companies to accept it with a price differential and find a market for it with traders, processors, etc. Rejection of second grade produce can be a strong incentive for outgrowers to consider alternative buyers and even sell all of their produce to them.

10) Provide or facilitate the provision of support services to outgrowers

Providing or facilitating the provision of needed products and services to outgrowers can generate loyalty to the company and incentives for outgrowers to stay in the program. In such situations many outgrowers do not want to side-sell as it could result in their being forced to leave the outgrowing operation.

Following are examples of products and services companies can either provide or facilitate access to that help reduce the incidence of side-selling by creating loyalty and incentives to stay in the program.

- Good quality seeds
- Technical extension services
- Credit
- Fertilizer
- Purchasing different crops from outgrowers' on a year-round basis
- Working with outgrowers to adopt optimal crop rotation schedules that are profitable for the farmer and meet company needs
- Allowing farmers to sell production not produced under contract to other markets
- Encouraging outgrowers when possible to take on value-added activities, e.g. drying, sorting, cleaning, storage, etc. to earn additional more income.

In evaluating the support they receive from companies, outgrowers tend to put the highest value on good quality seed and technical extension services. When a company can assure at least these two things, it provides farmers with important incentives to stay in the program and reduces the probability of side-selling.

11) Be strict in enforcing contract requirements

It is important for companies to send a clear message when outgrowers or lead farmers do not comply with agreed-upon operations and restrictions, such as selling to other companies, diverting seed for personal use, not applying agreed-upon production packages, etc. If the other outgrowers do not see that there are consequences to this behavior it is unlikely to stop and may ultimately result in failure of the outgrowing operation. Strict enforcement of policies and rules at the outset also can result in a reduced need over time for extensive monitoring.

IV. Role of Development Organizations (DOs) in Facilitating Outgrowing Operation Development

This section presents the role that development organizations (DOs) play in facilitating the establishment and growth of outgrowing operations. It presents principles and lessons-learned that DOs can use to structure their collaboration with targeted companies and help ensure long-term success and a positive impact for both the company and the outgrowers who comprise the DO target group. The section begins with a discussion on the role of the DO in promoting outgrowing operations, and how a DO might establish such a program and identify companies with which to work. This is followed by a discussion that presents general principles on how DOs can successfully *facilitate* the development of outgrowing operations.

RATIONALE FOR DOS TO SUPPORT OUTGROWING OPERATIONS

The promotion of mutually beneficial outgrowing operations between companies and farmers can result in lasting benefits for both parties. This kind of activity can help DOs achieve their own goals of creating meaningful and sustainable impact for producers and promoting the competitiveness of developing country industries. There is a strong rationale for DOs to promote such operations in situations where mutually beneficial relationships are possible and where it makes economic sense.

ESTABLISHING A PROGRAM AND IDENTIFYING COMPANIES

1) How and why a DO might become involved in promoting outgrowing

The interest a DO has in promoting outgrowing operations can be the result of:

- A value chain analysis that identifies opportunities to collaborate with companies that want to develop outgrowing operations
- An approach that looks for *lead firms* – in any sector – that have a commercial relationship with a large number of MSMEs. The DO can facilitate a collaborative relationship between the two that benefits the farmers
- An organic approach in which opportunities for promoting outgrowing operations may arise through a DOs work in other sectors or as a result of its local relationships
- A company with an interest in promoting outgrower operations might contact a DO directly.

2) Selecting companies to work with

It is important for DOs to establish clear criteria for selecting companies with which to work. In general, it is preferable to collaborate with companies that have:

- ***A strong rationale and business case for adopting an outgrower scheme –*** helps ensure the success of the collaboration
- ***Existing or potential commercial linkages with large number of outgrowers*** – facilitates larger scale impact and allows a DO to use its resources cost-effectively

- ***Sufficient financial strength and a long-term perspective*** – i.e., are in a position to make needed investments and have the patience to wait for benefits to materialize
- ***Strong demand for their products, an ability to compete in end-markets*** – and are in a position to influence the outgrowers they buy from / sell to by helping them produce to specification, training them to use new products, services, techniques, etc.
- ***Potential to influence their industry –*** by developing new strategies and approaches that serve as models for other companies to learn from and emulate
- ***An acceptable reputation –*** that reduces the risk of problems due to inappropriate behavior
- ***A willingness to collaborate openly and transparently –*** that minimizes problems.

DOs can use different methods to assess companies against these criteria:

- Conduct due diligence during value chain analysis
- Organize stakeholder meetings
- Request applications that 1) present their plans for outgrowing operations and 2) propose forms of collaboration with, and support from, the DO in line with DO guidelines.

Additional lessons DOs have learned in working with companies to start or expand outgrowing operations are:

- DOs should not push the idea of outgrowing on companies that don't have adequate need or justification for such an operation
- Larger companies with adequate resources and a long-term vision make better collaborators, especially in competitive markets in which companies may engage in price wars
- Companies conducting outgrowing operations with crops in *closed marketing systems* that limit outgrower opportunities to side-sell to other buyers have an inherent advantage
- Building a successful collaboration between a DO and a company requires building mutual trust, which can be a time-intensive process (*see box*).

ITC India and the GMED Project

It took almost six months from the time of first contact to the signing of an MOU between ITC and GMED (a USAID-funded project). Part of the delay could be attributed to operational issues, but the main reason was the time it took for the two parties to trust one another. GMED was an unknown entity in India and partnering with them could have been a big risk for ITC as it developed its supply chain strategy with GMED advice. During this time the GMED team met regularly with ITC and slowly proved its credentials. GMED had a strong manager with extensive experience and it used international consultants and expert professionals in its initial interactions with ITC, which piqued ITC's interest and built confidence in GMED's technical competence and ability to deliver. As fresh produce procurement from farmers was a relatively new concept in India, ITC appreciated that the GMED team had had done similar work in other countries. Gradually ITC's trust and confidence in GMED's abilities grew and eventually they entered into a formal partnership.

3) Number of companies to work with

Once a DO has identified companies with which it might want to collaborate, the DO needs to decide how many companies with which to work. In general, working with a larger number of companies can lead to greater impact on both the value chain and outgrowers by:

- Increasing the number of outgrowers impacted
- Fostering competitiveness among the companies
- Ensuring the program can continue if a company drops out or fails to fulfill its commitments
- Promoting broader industry impact.

In some cases, DOs might make an exception to working with multiple companies and work with just one if the targeted company:

- Transacts with a very large network of outgrowers
- Is exceptionally placed to set an example for the industry
- Insists on *exclusivity* in its arrangements with the DO (will collaborate only if the DO agrees not to work with its competitors)
- Requires a high degree of support in overcoming immediate issues.

Note: The availability of resources—staff, budget, and timeframe—for achieving results also can limit the number of companies with which a DO works.

In working with more than one company, a DO has to be sensitive to issues of competition and:

- Support companies that work with different crops or do not compete directly
- Refuse to support companies conducting outgrowing operations in the same area, which could jeopardize the first company's investment, lead to outgrower side-selling, and result in the poaching of outgrowers and field staff by both companies.

DOs also need to be careful not to provide unfair advantage to one company over another. One way of ensuring this is for the DO to offer support to any interested company that meets its criteria (listed above). If necessary, the DO can establish more stringent criteria to limit the number of eligible candidates. Usually though, DOs can achieve broader and more systemic impact by working with as many companies as possible and minimize the risk of not achieving its objectives if some companies drop out or fail to fulfill their commitments.

GMED Project, India

Though GMED's initial strategy was to work with a few companies, it later decided to work exclusively with ITC on an ambitious outgrowing operation with vegetable farmers. As supply chain development was an important ITC strategic element, it wanted an exclusive arrangement with GMED and did not want the project work directly with its competitors. GMED decided to provide exclusivity to ITC for a period of 18 months and both parties agreed that after that time GMED could enter into partnership with other retail players and share project knowledge and experience widely with the entire sector.

GENERAL PRINCIPLES FOR DO FACILITATION OF OUTGROWING OPERATIONS

Once a DO selects the companies it plans to support, it must establish and structure collaborative arrangements with them. The principles are based on DO experience in promoting company outgrowing operations and are described in detail below the list.

A. Respect the company's experience and knowledge
B. Establish credibility
C. Develop an appropriate MOU with companies
D. Do not undertake the role of intermediary or negotiator
E. Develop professional relationships between DO and company staff
F. Create the right incentives
G. Structure cost-sharing appropriately
H. Develop company competitiveness
I. Monitor agreements with companies.

A. Respect the company's experience and knowledge

Owners / managers of companies wanting to engage in outgrowing operations usually have significant experience in their respective industries and a good understanding of the business environment. Management knows what it means to run a business and DOs must respect their experience and knowledge and take care not to take a paternalistic attitude toward them or think they know the business better.

Even if companies have never engaged in outgrowing operations before, managers' experience running a commercial enterprise prepares them to make practical decisions with regard to outgrowing operations that the DO may not always agree with or fully understand. The DO must not think it knows all the answers and DO managers should be flexible and work closely with company management on intervention design.

B. Establish credibility

To succeed, DOs need to establish credibility with the companies with which they want to work. Without it, companies may be reluctant to enter into agreements that affect their time, resources and business. On their side, companies should understand that building and maintaining credibility is a time-intensive endeavor and one that lasts throughout the collaboration.

A good first impression is an integral step in establishing credibility and it begins during initial meetings, prior to any actual collaboration between the company and the DO. During these preliminary meetings the DO should:

- Demonstrate respect for the role the company plays in the value chain and the contributions it makes to the economy
- Communicate its goals and rationale for supporting the company, e.g. helping it develop (or improve) outgrowing operations fosters sustainable benefits for the outgrowers who supply the company with the product(s) it needs
- Present a realistic overview of not only the potential benefits, risks and challenges, but also of the company's long-term investment it requires of the company
- Provide a good introduction of the program and how it works, including the:
    - DO's role as a *facilitator*, **not** an *intermediary (see **D** below)*

    - Possibility of providing cost shares for selected activities
    - Timeframe of assistance, etc.
- Stress the goal of sustainable impact and the importance of collaboration to achieve it and use examples of programs that have had only short-term impact because they ignored or tried to replace the functions of local market actors
- Be transparent about support to other companies, while at the same time stressing respect for the confidentiality of each company and avoiding working in the same area with more than one company.

Actions speak louder than words and it is through its actions that the DO must establish itself as a credible collaborator in the eyes of a company. Beginning in the initial stages of collaboration the DO can:

- Help the company assess the feasibility of its outgrowing operation
- Take company representatives to visit successful outgrowing operations, either in-country or elsewhere
- Demonstrate responsiveness and professionalism in supporting the company
- Display professionalism in negotiating and developing cost share agreements
- Show capacity to provide useful and prompt technical support once activities begin
- Respect principles of confidentiality regarding company operations.

C. Develop an appropriate Memorandum of Understanding (MOU) with companies

There is no fixed structure or format for MOUs with companies. Some may discuss very general principles, while others describe detailed mutual expectations and deliverables. In some cases, the parties can establish a general MOU and amend it with subsequent sub-agreements that describe specific activities and cost-share agreements.

Whatever the form of the underlying MOU, it must include some standard contractual language. While it may be awkward to review these matters with the company in the early stages, it demonstrates the serious approach the DO takes to business and collaboration. Here are some general suggestions for structuring an MOU:

- Establish clear milestones and indicators
- Include language that allows the DO to monitor progress on work plan benchmarks and cost-share agreements and to conduct impact assessments
- Link cost-share payments to specific, measurable activities
- Specify *exit strategies* for each cost-share activity with companies to ensure sustainability
- Stipulate the type of information the company must provide the DO without creating undue burdens
- Set benchmarks and agree on measurement indicators and timeframes.

D. Do not undertake the role of intermediary or negotiator

DOs should not intervene in negotiations between companies and outgrowers as this can lead to market distortions and unsustainable impact. DOs need to allow companies and outgrowers to work out the most appropriate structures without imposing their own, sometimes biased ideas of the best organizational structure to use, e.g. groups or cooperatives.

Buyers can achieve product aggregation and economies of scale by several means, including using *lead farmers* to help them manage their relationships with outgrowers. Offering to organize groups on behalf of companies is risky and can create problems such as:

- Lack of company commitment to outgrowers
- Resentment among producers if promised commercial links between the company and groups do not materialize
- Confusion among all parties about the role of the DO and who is responsible for what
- Delays in establishing sustainable relationships between the company and outgrowers.

For these same reasons, DOs should and not become directly involved in structuring relationships and defining responsibilities between companies and outgrowers.

E. Foster the development of professional relationships between DO and company staff

To ensure a successful collaboration, it is critically important to manage relationships between DO and firm staffs. The DO and company should work together to develop a system for resolving any conflicts that might arise with initial efforts to resolve conflicts beginning at the supervisory level and moving up to mid-level management if that does not succeed. If these efforts do not resolve the problem then the top management of both the company and the DO can meet. Potential sources of conflict between DO staff and company staff could involve:

- DO staff taking a paternalistic or superior attitude towards company field staff by trying to instruct them or tell them what to do, etc.
- The often higher pay and better working conditions that DO staff enjoy compared to company staff
- DO staff promises and commitments to outgrowers that companies are unable to honor
- Performance evaluations of field staff that company management asks a DO to undertake can result in field staff reluctance to share problems and mistakes with them.

It is important that the DO ensure the company engages directly with outgrowers and not through the DO. This serves to build mutual trust, and strengthen company relationships with producers, and helps ensure sustainability of the operations. DO staff should not:

- Disseminate information or direct farmers on behalf of the company; this can create confusion, especially if directives contradict what company representatives say
- Arrive at meetings in large vehicles, which can create unrealistic expectations.

F. Create the right incentives

The DO can play a key role in mitigating the risks that companies face in establishing or expanding an outgrowing operation. However, the DO must be careful to strike the right balance when it comes to providing incentives or subsidies. While there are no hard and fast rules about this, DOs should follow certain principles to ensure that companies take responsibility for new activities and that sustainability can be achieved.

Subsidies – also referred to as cost-shares – are generally accepted as a way to provide the technical support that builds company capacity to develop outgrowing operations and pilot training and demonstration activities, to conduct feasibility studies, and to carry out research and development (R&D) activities. Subsidies are more difficult to justify when they cover all or part of a company's recurring operational costs, personnel, or physical assets. In such cases, the risk

of creating dependency, distorting markets, and slowing ownership of the process is much greater and should be avoided.

General rules of thumb for cost-share agreements include:

Justifiable cost-shares:

- Staff capacity building
- Initial outgrower training and demonstration activities
- Activities that link companies to new markets, buyers, equipment/input suppliers, etc.
- Technical assistance for R&D, new product development, market research, feasibility studies for new equipment, etc.

Difficult to justify cost-shares:

- Recurring operational or working capital costs
- Physical assets and infrastructure
- Company personnel

To help ensure sustainability, DOs should make cost-shares contingent upon a demonstrated commitment by the company to hire staff, make specific investments or undertake other activities related to the outgrowing operation. In this way, companies interested in DO support can *self-select*.

Smart Subsidies: The Case of ITC and GMED

GMED decided early on in the project that it would act as a facilitator and focus only on building the technical capacity of companies it supported to ensure it did not create dependency. In its work with ITC, GMED paid the consultant's fees and ITC paid for the hardware, field-level investments and all field staff costs—an arrangement that ensured ITC was taking responsibility for all new outgrowing operations, bearing most of the costs and making the requisite investments. Once the system became established, ITC could scale up on its own.

G. Structure cost-share agreements to ensure sustainability

As discussed above, collaboration between DOs and companies often includes cost-sharing that allows DOs to offset some costs and mitigate risks companies face in making new investments that benefit them and their outgrowers. Cost shares also can provide incentives for companies to move forward with an initiative they might otherwise be unwilling or unable to undertake.

An important aspect of creating the right incentives is to structure cost-shares in a way that reduces the risk of creating dependency and increases the chance of sustainability. General considerations for structuring and managing cost-share agreements include:

- Use the cost-share mechanism only to get things going and build company capacity
- Decrease the cost-share over time by, for example, providing 70% in the first year, 40% the second year, 10% the third year, etc. to ensure duration is limited to establishing needed systems and capacity

- Continue supporting the company until cost-share activities cease
- Keep the cost-share percentage as low as possible to encourage company ownership, while still providing incentives and helping to mitigate risk
- Include specific milestones in cost-share agreements and renegotiate agreements each year based on achievements during the previous year. (See *Intervention Brief #6,* **Provide TA for Outgrowers**, for a list of cost-share options.)

H. Develop company competitiveness

DO efforts to assist targeted companies increase their competitiveness helps ensure they can profitably satisfy their end-markets and positively impact outgrowers. Examples include:

- Developing or improving finished products that meet end-market needs and specifications
- Identifying new buyers for products
- Developing or improving production and packaging processes
- Purchasing more efficient machinery or equipment
- Accessing finance to expand their operations, etc.

In many cases, DOs can help develop or improve value chain *support markets* by working with companies to identify firms or consultants offering commercial support services and assistance in certification, advertising, strategic planning, IT applications, financial management, access to inputs and machinery, etc. The DO can facilitate linkages between targeted companies and the service providers and help the latter adapt services to company needs. In addition, the DO can provide companies with one-time incentives to try the services after which they would pay the full cost.

Although the ***Question Guides*** and ***Intervention Briefs*** presented in this manual are designed specifically for those engaged in outgrowing, many of the principles, questions and interventions can guide the DO in working with firms that provide business support products and services.

I. Monitor the agreements with companies

It is important that DOs monitor the work plans and the cost-share agreements they have with companies to ensure they are making the agreed upon investments and conducting activities appropriately. It often is useful when negotiating an MOU with a company for the DO to set clear milestones and indicators and to include language that allows it to monitor activities regularly and conduct periodic impact assessments. The company can use its internally-generated data and reports to provide DOs with most of the necessary information. If DOs need additional information, they should work with the company to get it, while keeping in mind the need to not unnecessarily burden the company by collecting irrelevant information.

ITC India

GMED held regular review meetings with top ITC management to ensure that work was progressing according to the agreed-upon plan. These meetings served monitoring purposes and, in addition to them, GMED staff and consultants made periodic field visits with ITC staff and the project established a regular feedback mechanism to further monitor progress. The GMED team felt that it could take up to two years or three to four cropping seasons before an assisted company would be able to fully manage its outgrowing operations.

FAIDA MaLi (Tanzanian Development Organization)

In monitoring the MultiFlower (MF) company commitment to its agreed workplan, FAIDA used the crop calendar, conducted regular field visits and required MF to submit periodic progress reports. Additionally, both MF and FAIDA MaLi staffs submitted reports to supervisors on their field activities. If the FAIDA field agent found that MF was not performing as agreed, they communicated their concerns to their manager who then contacted the MF manager responsible for outgrowing activities to discuss and request improvements.

V. Specific Capacity-Building Activities – Intervention Briefs

This section presents a series of **Intervention Briefs** that provide concrete and practical examples of how development organizations can help build the capacity of companies to successfully develop and manage the different components of an outgrowing operation. DOs should use the briefs to help companies:

1. **DECIDE WHETHER TO ESTABLISH AN OUTGROWING OPERATION**
2. **HIRE STAFF**
3. **SELECT AND ENGAGE LEAD FARMER**
4. **SELECT OUTGROWERS**
5. **COMMUNICATE WITH OUTGROWERS**
6. **PROVIDE TECHNICAL ASSISTANCE TO OUTGROWERS**
7. **PROVIDE CREDIT TO OUTGROWERS**
8. **ENSURE OUTGROWER ACCESS TO APPROPRIATE INPUTS, INCLUDING SEED**
9. **DETERMINE PRICES FOR OUTGROWER PRODUCE**
10. **MANAGE PROCUREMENT FROM OUTGROWERS**
11. **DEVELOP A SEED PROGRAM**
12. **DEVELOP DEMONSTRATION PLOTS**
13. **DEVELOP TRIAL PLOTS**
14. **DEVELOP MANAGEMENT INFORMATION SYSTEMS**

And, finally, the briefs help DOs:

15. **FACILITATE COMPANY VISITS TO SUCCESSFUL OUTGROWING OPERATIONS**

Each brief includes:

- A description of company initiatives the DO is supporting
- A list of the critical issues, based on the corresponding Question Guide, the company needs to address
- Ways the DO can support the company in addressing these issues
- Cost-share options: financial support to help mitigate risks and build capacity
- Typical mistakes that DOs make.

INTERVENTION BRIEF #1

Building the capacity of companies engaged in outgrowing to:
DECIDE WHETHER TO ESTABLISH AN OUTGROWING OPERATION

Description of company initiatives the DO is supporting:
There are many things that a company needs to consider before establishing an outgrowing operation. Given the investment and long-term commitment needed to make outgrowing successful, a company should carefully weigh the potential risks and rewards and not take the decision lightly.

The company should use the question guide to address the following critical issues:

- Decide what its rationale for establishing an outgrowing operation is and how it could contribute to the company's operations, competitiveness and/or growth
    - What advantages would an outgrowing operation provide the company compared with the way it currently sources raw materials / products?
    - Review the reasons for establishing an outgrowing operation in light of the company's ability to compete in end-market(s)
- Determine the risks and challenges the company might face in developing an outgrowing operation
- Determine why farmers might be interested in participating in the outgrowing operation
- Identify the risks farmers would face if they participate in the outgrowing operation
- Identify which outgrowing organizational model the company wants to use
- Determine the projected maximum costs which would allow the outgrowing operation to be feasible
- Determine the projected costs in accordance with the proposed structure of the outgrowing operation
- Identify the geographic areas where it will conduct the outgrowing operations.

Ways the DO can support the company in addressing these issues:

- Use the question guide to help the company determine whether it should establish an outgrowing operation
- Conduct presentations or short training sessions to educate company staff on outgrowing operations
- Assist the company identify potential crops and/or geographic areas for outgrowing operations
- Help the company determine the feasibility of an outgrowing operation, including the projected costs – this can be done through facilitating the company in systematically tracking the cost implications of each of the choice and decision made through the use of all question guides.
- Organize exposure visits for the company to successful outgrowing operations in the region or other countries.

Cost share options include:

- DO can cost-share exposure visits
- DO can cost-share agronomic technical specialist to help the company assess the feasibility of an outgrowing operation.

Typical mistakes DOs make:

- Telling companies that an outgrowing operation can help them achieve immediate savings in raw material costs. *In fact, when companies compare what they pay during the first few years of outgrower operations with what they used to pay to procure raw materials from traders, most do not see a reduction in costs.*
- Insisting that the company use a particular model of outgrowing operation
- Proposing that it, rather than the company, should organize the farmers. *Doing so can result in unrealistic expectations by both company and outgrowers, reduce the company's sense of ownership, lead to dependency, etc.* (See *Intervention Brief #4*—**SELECTING OUTGROWERS**, for more on this topic.)

INTERVENTION BRIEF #2

Building the capacity of companies engaged in outgrowing to:
HIRE STAFF

Description of company initiatives the DO is supporting:
Companies need to consider a range of factors when hiring staff to manage their outgrowing operations. These include how many staff to hire; where they will live; the required skills and experience; and remuneration among other things.

The company should use the question guide to address the following critical issues:

- Determine how many staff persons they need
- Determine where they will base staff
- Decide if they will recruit field agents from within or outside the targeted outgrowing area
- Identify the skills and experience the coordinator and field agents must have
- Identify key coordinator and field agent duties and responsibilities
- Determine a remuneration package for staff.

How the DO can support the company in addressing these issues:

- Use the question guide to help prepare the company to hire staff
- Assist with development of job descriptions
- Refer candidates
- Share information and insights regarding performance-based remuneration packages.

Cost share options include:

- DO may help finance the services of an expert in developing performance-based remuneration packages
- DO may contribute to recruitment costs, e.g. advertising and other services, particularly for the coordinator, but the company should directly manage all recruitment activities.

Typical mistakes DOs make:

- Moving forward with technical and financial support to a company before it hires staff to manage the outgrowing operations
- Hiring field staff for its own program from the company it is supporting
- Providing allowances or higher remuneration to company field staff by paying per diem, fuel allowances, etc. *Such allowances are not sustainable for the company; they can create the wrong signals or incentives for field agents and could result in their leaving the company after support ends.*

INTERVENTION BRIEF #3

Building the capacity of companies engaged in outgrowing to:
SELECT AND ENGAGE LEAD FARMERS

Description of company initiatives the DO is supporting:
In an indirect or intermediary outgrowing model, companies often need to choose *lead farmers* who can serve as the company's primary liaison with outgrowers. Typically, lead farmers have a contract or agreement with the company to perform certain roles and functions.

The company should use the question guide to address the following critical issues:

- Determine the role (if any) of lead farmers in the outgrowing operation
- Identify criteria for selecting lead farmers
- Develop a strategy for selecting lead farmers
- Decide what, if any, support to solicit from government agricultural services in selecting lead farmers
- Develop a remuneration plan for lead farmers
- Design a system to change lead farmers if necessary.

How the DO can support the company to address these issues:

- Use the question guide to facilitate the company in the lead farmer selection process
- Identify resource people who can propose lead farmer candidates, e.g. community leaders, business people, government officials, etc.
- Travel with the company on visits to identify lead farmers, but do not negotiate with potential lead farmers on behalf of the company.

Cost-share options:

- There is limited scope for the DO to cost-sharing in this instance. The company should conduct this initiative with its own staff and resources, while the DO can support the process with technical assistance.

Typical mistakes DOs make:

- DO should not serve as an intermediary between the company and potential lead farmers; the company must take responsibility for selecting and negotiating with lead farmers
- DO should not promote strategies in which producers elect their lead farmers – as they may do with producer organizations – because outgrowing operation lead farmers have a contractual relationship with the company.

INTERVENTION BRIEF #4

Building the capacity of companies engaged in outgrowing to:
SELECT OUTGROWERS

Description of company initiatives the DO is supporting:
Outgrower selection is integral to the success or failure of any outgrowing operation. A number of avenues are available for selecting outgrowers and the one used depends on the outgrowing model the company uses.

The company should use the Question Guide to:

- Identify criteria for selecting outgrowers
- Design and implement the outgrower selection process.

How the DO can support the company to address these issues:

- Use the question guide to assist the company design and implement the outgrower selection process
- Provide examples of criteria and selection processes other companies use the company can adapt to its own operation
- Identify resource people and intermediaries who can propose candidates to the company, which should make the final decision.

Cost -share options include:

- There is limited scope for cost-sharing as the company should conduct this initiative with its own staff and resources. The DO can, however, support the process with technical assistance, as described above.

Typical mistakes DOs make:

- DO serves as an intermediary between the company and outgrowers by forming producer groups, negotiating with the company on behalf of outgrowers, etc. *This can create a number of problems, including fostering dependency on the DO, hindering development of relationships between outgrowers and the company, etc. Participation in an outgrowing operation should be seen as a business relationship between the company and the outgrowers*
- DO mobilizes and even preselects outgrowers to propose to the company. *This can cause problems such as creating unrealistic expectations of the DO by both company and outgrowers, reducing the company's sense of ownership of the outgrowing operations, etc. The company should be responsible for the entire selection process, though the DO may provide technical support, as described above.*

INTERVENTION BRIEF #5

Building the capacity of companies engaged in outgrowing to:
COMMUNICATE WITH OUTGROWERS

Description of company initiatives the DO is supporting:
It is important that the company maintain close communication with its outgrowers both to inform them of changes, e.g. new / additional buyer requirements, and to quickly address sensitive issues outgrowers may raise. Close, transparent communications can help build good relationships, establish trust between both parties and foster outgrower loyalty to the company.

The company should use the question guide to address the following critical issues:

- What it wants to communicate to outgrowers
- How it will communicate with outgrowers
- How to ensure two-way communication
- How to collect and manage the information collected from outgrowers.

How the DO can support the company to address these issues:

- Use the question guide to lead the company through its thinking and planning exercises
- Design visual aids that can help the company communicate effectively with outgrowers, especially those who are illiterate
- Develop training packages for field agents and lead farmers that address weaknesses in their communication skills
- Expose company to best practices and methods of communicating with outgrowers, including transparent negotiation of contract agreements, etc.
- Support the company in organizing trainings, field days and demonstrations for outgrowers. Use the Question Guides #6 & #10 and Intervention Briefs #6, #11, & #15.

Cost-share options include:

- DO can cost-share the development of training packages that improve communication skills
- DO may contribute toward hiring a professional to assist in designing visual aids.

Typical mistakes DOs make:

- DO communicates with the company on behalf of outgrowers (or vice versa). *This can distort information, hinder direct communications between the company and outgrowers and foster dependency on their intermediary role*
- DO provides transport to company field agents and/or lead farmers to help them overcome logistical challenges to good communication with outgrowers. *This assistance makes them dependent on the DO and is not sustainable*
- DO finances sophisticated and expensive communication systems such as radios and satellite phones. *This type of assistance is unsustainable as the company cannot maintain or replace these systems.*

INTERVENTION BRIEF #6

Building the capacity of companies engaged in outgrowing to:
PROVIDE TECHNICAL ASSISTANCE TO OUTGROWERS

Description of company initiatives the DO is supporting:
In addition to good quality seeds, outgrowers greatly value the company's technical assistance (TA), which may include training / coaching sessions, field-based technical advice and demonstrations. TA helps outgrowers produce according to company specifications and gain the yields and quality that benefit both outgrower and company. Not only does TA increase outgrower productivity to make company operations more cost effective, it improves farmer profitability, which encourages and motivates them to work better and increases their loyalty to the company.

The company should use the question guide to address the following critical issues:

- Technical assistance and training the company should provide outgrowers
- Field agent tasks and objectives when providing field-based technical advice and extension services to outgrowers
- Information company staff need to collect and record during field visits
- Motivating field agents to provide good technical support to outgrowers
- Defining topics to cover during outgrower training / coaching sessions
- Training / coaching module contents
- Location of training / coaching sessions
- Composition of training / coaching team
- Criteria to use for selecting expert farmers to participate on coaching team
- Timing of training / coaching sessions for outgrowers
- How to make training / coaching sessions cost effective
- How to develop the training / coaching team members' capacity
- Other techniques for promoting good outgrower production practices.

Ways that the DO can support the company to address these issues:

- Help the company think through critical issues using the question guide
- Assist company to organize training / coaching teams comprising staff, expert farmers, etc. who can be responsible for organizing the outgrower training / coaching activities
- Work with company staff to develop training / coaching modules and presentation materials for different phases of production – planting, mid-season, post harvest, etc. In addition to providing technical expertise on the targeted crop, the DO can help / encourage the company to incorporate participatory adult learning methodologies into training modules – question / answer, participatory field demonstrations, etc.
- Evaluate the impact of training / coaching activities on farmer productivity to determine cost effectiveness and make improvements; ask farmers to evaluate their satisfaction with the TA
- Provide short-term technical specialists with knowledge of targeted crops to build company staff capacity.

Although the DO can take the lead on, and responsibility for, these activities, it is preferable that it support the company in doing them:

- Organize a training of trainers for company training / coaching team in which they review the training modules and then practice delivering them. The DO can build team capacity in both the technical elements and participatory adult learning methodology and, if necessary, can work jointly with the company team to lead the activity
- During the first few training sessions, the DO should monitor the team's training / coaching activities and provide detailed, on-going feedback then follow-up with selected monitoring visits throughout the project, providing comments as needed.

Cost-share options include:

- Full funding for preparing and conducting ToT workshop for company training / coaching teams
- Partial funding of training / coaching sessions, for example 70% of sessions in year one, 40% year two, 10% year three, etc.
- Partial funding of training materials such as pamphlets and visual aids (same percentages as above)
- If the company conducts multiple sessions, the DO can estimate / budget costs with the company and pay the company an agreed-upon cost-share based on proof that the event took place. Payments in this case could be made based on signed participant lists rather than detailed receipts.

Typical mistakes DOs make:

- DO staff and technical consultants directly train outgrowers. *This does not build company capacity in a sustainable way*
- DO organizes and manages the outgrower training / coaching activities. *This results in the same problem noted above.*

INTERVENTION BRIEF #7

Building the capacity of companies engaged in outgrowing to:
PROVIDE CREDIT TO OUTGROWERS

Description of company initiatives the DO is supporting:
Companies engaged in outgrowing operations frequently need to provide their outgrowers with credit that can be one or a combination of seed, a full package of inputs or cash. The amount of credit extended to farmers, and the mechanisms for doing so, depend on a range of factors.

The company should use the question guide when considering the following critical issues:

- Rationale for providing credit to outgrowers
- Form and level of credit to provide
- Risks and benefits of providing credit to farmers
- Whether financial institutions and/or companies supplying inputs are willing to enter into tripartite arrangements
- Whether to obtain credit directly from financial institutions, e.g. banks, microfinance institutions, etc.

Ways the DO can support the company in developing *credit for farmers* policies: (*though the DO can take the lead on, and responsibility for, these activities, it is preferable that it support the company in doing them)*

- Guide company through thinking and planning about credit using the question guide
- Identify the credit needs and/or capital short-falls of existing and potential outgrowers
- Collect information on loan products, lending practices, branch locations, etc. for area financial institutions and prepare a short-list of potential institutions for further exploration with the company on forming tripartite arrangements or facilitating direct financing between a financial institution and the company
- Facilitate visits to other companies and/or financial institutions currently engaged in tripartite arrangements to learn how they are organized.

The DO should support the company in doing the following:

- Prepare and present a proposal to selected financial institutions for establishing a tripartite arrangement
- Assist outgrowers complete documents and forms from financial institutions for opening an account, applying for a loan, etc.
- Design a management information system for the credit program
- Develop and package funding proposals to specific donor programs that provide either soft loans and/or assistance in establishing relations with local financial institutions
- Assess the feasibility for insurance companies to provide crop insurance to outgrowers and facilitate arrangements with the company to insure outgrowers.

DO could also work directly with financial institutions to:

- Develop lending products that correspond to the production and payment cycles of outgrowers

- Develop procedures for streamlining the opening of individual accounts for outgrowers
- Develop internal procedures for institutionalizing arrangements with the company and outgrowers.

Cost-share options include:

- Share costs of visits to companies and/or financial institutions involved in tripartite arrangements
- Technical consultant to design a management information system for the credit program.

Typical mistakes DOs make:

- Provide subsidized credit to outgrowers. This is an unsustainable and undesirable activity.

INTERVENTION BRIEF #8

Building the capacity of companies engaged in outgrowing to:
ENSURE OUTGROWER ACCESS TO APPROPRIATE INPUTS, INCLUDING SEED

Description of company initiatives the DO is supporting:
Access to quality inputs can be an important aspect of outgrowing operations for several reasons:

- Ensures outgrowers grow the desired variety and quality of product
- Ensures the quality of inputs that can increase production
- Conforms to buyer requirements, particularly in high-end markets.

For many companies engaged in outgrowing operations, the sale and distribution of good quality inputs, particularly seed, to outgrowers is one of the most important elements of success. For this reason a company has to take particular care in designing input distribution arrangements.

The company should use the question guide to address the following critical issues:

- Whether it needs to facilitate access to inputs for outgrowers
- Review options and develop a strategy for facilitating access to needed inputs.

If the company is distributing inputs itself:

- Who it will procure the inputs from
- How it will sell the inputs to outgrowers
- How it will manage the logistics of selling inputs to individual outgrowers
- How it will collect them if upfront payments are required
- How it will collect payments if the company is supplying outgrowers with credit
- When it will distribute the inputs
- How it can minimize potential problems raised by relying on lead farmers or producer groups.

If the company is relying on third party input suppliers:

- What types of arrangements can it make with them?

Ways the DO can support the company to address these issues:

- Use the question guide to help the company determine its strategy and develop a work plan that ensures outgrowers have access to needed inputs.

Though the DO can take the lead on, and responsibility for, these activities, it is preferable that it support the company in conducting them:

- Collect information about inputs offered, prices, location and distribution network organization, etc. on different input supply companies and prepare a short-list of potential suppliers for further exploration with the company
- Identify and organize exposure visits to other companies engaged in outgrowing operations to see how they ensure access to inputs for their outgrowers (for details, see *Intervention Brief #15*—**FACILITATE COMPANY VISITS**).

- Identify and organize exposure visits to input suppliers that work with companies engaged in outgrowing to see how their arrangements are organized
- Explore options for facilitating linkages between outgrowers and financial institutions for credit to purchase inputs (refer to *Question Guide #7* and *Intervention Brief #7*—**CREDIT TO OUTGROWERS**).

DO should support the company to:

- Identify the types and quantities of inputs that outgrowers will need
- Prepare and present to selected input suppliers a proposal that describes possible arrangements for them to provide inputs, technical support, etc. to outgrowers
- Build capacity of company staff to train and provide demonstrations to outgrowers in correct use of inputs (refer to *Question Guides #6 & #12* and *Intervention Briefs #6 & #12*—**TECHNICAL ASSISTANCE TO OUTGROWERS** and **DEMONSTRATION PLOTS**).

DO also could work directly with input suppliers to:

- Develop / expand their distribution networks
- Develop a training program for their network of retailers and stockists on how best to advise farmers on the correct use of their products
- Develop special products or packaging designed to meet company and outgrower requirements
- Build their capacity to provide technical support, including training, demonstrations, etc. to company outgrowers.

Cost-share options include:

- Trainings and demonstration plots focused on the correct use of inputs (see *Intervention Brief #6 & #12*—**TECHNICAL ASSISTANCE TO OUTGROWERS** and **DEMONSTRATION PLOTS**)
- Input supplier initiatives to develop / expand distribution networks that provide outgrowers with improved access to quality inputs
- Exposure visits to other companies and/or input suppliers (see *Intervention Brief #15*—**FACILITATE COMPANY VISITS**).

Typical mistakes DOs make:

- Taking on an intermediary or negotiation role between the company and input suppliers
- Distributing inputs to outgrowers on behalf of the company. *This can result in problems of sustainability, weak relationships between outgrowers and input suppliers, inputs going to the wrong farmers, company blaming the DO for problems, etc.*
- Subsidizing the provision of inputs to outgrowers
- Providing inappropriate agronomic advice to the company, sometimes by staff lacking expertise.

INTERVENTION BRIEF #9

Building the capacity of companies engaged in outgrowing to:
DETERMINE PRICE FOR OUTGROWER PRODUCE

Description of Company initiatives the DO is supporting:
Companies have different options when it comes to setting prices with outgrowers. Three common pricing mechanisms are: 1) fixed prices, 2) market prices, and 3) split prices. More frequently however, are ***pricing formulas*** that combine elements of all three approaches to address the weaknesses of each mechanism.

The company should use the question guide to address the following critical issues:

- Determine the type of marketing system (open or closed) in which they operate
- Determine the kind of business – e.g. seed, commodity, etc. – they are conducting
- Establish production costs at outgrowers' level
- Determine who to involve in establishing the price
- Determine and adjust the right price.

How the DO can support the company to address these issues:

- Guide the company through thinking and planning using the question guide.

Assist company establish its pricing strategy and formula by exposing it to different examples and cases such as:

- Regular adjustment of spot market prices by a committee of company representatives and outgrowers
- Participatory costing exercises with farmers to establish commodity production costs
- Best practices regarding participatory price setting.

Support the company to:

- Conduct market research on end-market prices
- Determine outgrower production costs.

The DO also should help the company develop and organize training / dissemination activities for outgrowers that include:

- Workshops that help them understand the benefits of company assistance such as seeds, inputs and technology transfer
- Ensuring they understand the importance of trust in business relationships and the consequences of breaking agreements, e.g. the loss of inputs the following season and lower productivity
- Helping them analyze the changes in world market prices and how they affect the price they receive for their production
- Exposing them to examples of companies and outgrowers who maintain long-term commercial relationships that benefit both parties.

Cost-share options include:

- DO can cost-share the above-mentioned training and dissemination activities
- DO also may cost-share exposure visits for both the company and outgrowers to well-run, inspiring outgrowing operations
- DO could cost-share an agricultural technical specialist to help assess outgrower production costs, etc.

Typical mistakes DOs make

- DO gets involved in price negotiations between the company and outgrowers. *This is a critical aspect in the process of building relationships and trust between the company and outgrowers and therefore should take place between those two parties*
- DO encourages outgrowers to demand a fixed price at the beginning of the season. *This can create problems if market prices go higher and can interfere in the development of the relationship between the company and outgrowers*
- DO provides outgrowers with end-market prices, but does not help them understand the level of effort and costs the company incurs in bringing a product to market.

INTERVENTION BRIEF #10

Building the capacity of companies engaged in outgrowing to:
MANAGE PROCUREMENT FROM OUTGROWERS

Description of company initiatives the DO is supporting:
Well-managed procurement operations are critical to the success of any outgrowing operation and require careful logistical and financial planning. Because procurement transaction costs are passed on to farmers through deductions on the price they receive, efficiency improvements are critical and likely to have an immediate impact on the outgrowers.

The company should use the question guide to address the following critical issues:

- How and where to conduct the procurement operations
- How to organize and undertake the grading
- What cleaning and packing material to provide outgrowers
- How to organize payment and who to involve
- How to plan and organize transportation
- Alternative market for second grade material
- The type of procurement records to keep.

How the DO can support the company to address these issues

- Assist the company through thinking and planning using the question guide and the *Illustrative Procurement System Monitoring List.*

Though the DO may take the lead on, and responsibility for, these activities, it is preferable that it support the company in doing them:

- Identify and link the company to financial institutions to facilitate payments to outgrowers
- Provide information and examples of how procurement systems are managed to address issues of traceability, niche markets, etc.

The DO should support the company to:

- Establish systems and procedures that ensure adequate feed back to outgrowers regarding grade, quality and rejection of their produce
- Develop a payment system that is adequate, transparent and allows timely payment to each outgrower
- Explore ways and means for the company to devolve certain post-harvest activities to outgrowers to enable them to add value and profit to their product
- Explore alternative markets for lower-grade products that otherwise would be rejected.

Cost-share options include:

- Devolving certain functions to outgrowers such as cleaning and sorting may require investment at the outgrower level. The DO could facilitate this by cost-sharing with the company.
- The DO may also provide a percentage of the cost of financing exchange visits to other companies that have an exemplary procurement system (see *Intervention Brief #15—***FACILITATE COMPANY VISITS**)
- DO may cost share exposure visits to other countries for company and interested financial institutions to explore effective ways of paying outgrowers (refer to *Question Guide #7* and *Intervention Brief #7—***CREDIT TO OUTGROWERS**).

Typical mistakes DOs make:

- DO becomes directly involved in procurement, collecting and transporting produce from remotely located outgrowers to company collection points
- DO finances machinery for post-harvest value-adding activities without involving the company.

INTERVENTION BRIEF #11

Building the capacity of companies engaged in outgrowing to:
DEVELOP A SEED PROGRAM

Description of company initiatives the DO is supporting:
Gaining access to good quality seed may be the most important reason farmers participate in outgrowing operations. It also can motivate farmers to remain loyal to the company and not side-sell, an activity which would jeopardize their access to the seed.

The company should use the question guide to address the following critical issues:

- Decision whether to develop a seed program as part of their outgrowing operations
- Justification for having their own seed program
- Determination of what kind of seed program they want to develop
- Identifying sources of foundation or breeder seed
- Determining the level of investment required as well as the potential returns.

Ways the DO can support the company to address these issues:

- Use the question guide to assist the company design and implement the outgrower selection process
- Organize exposure visits to other companies with outgrowing operations that have successful seed programs (see interve *Intervention Brief #15*—**FACILITATE COMPANY VISITS TO SUCCESSFUL OUTGROWING OPERATIONS**)
- Organize international visits for companies to visit potential suppliers of new seed varieties
- Provide technical support for trial plots to test new varieties (see *Intervention Brief #12*—**DEVELOP TRIAL PLOTS**)
- Assist company conduct a feasibility study for on a new seed program.

Cost-share options include:
The DO can cost share:

- Technical specialists to advise / build company capacity to develop a seed program
- Exposure and international visits related to developing a seed program (see above)
- Trial plots to test new varieties (see above).

Typical mistakes DOs make:

- May become too involved in directly managing the company's seed development program thus hindering the company's ability to manage the program on its own over the long term.

INTERVENTION BRIEF #12

Building the capacity of companies engaged in outgrowing to:
DEVELOP DEMONSTRATION PLOTS

Description of company initiatives the DO is supporting:
Companies frequently use demonstration plots to show outgrowers effective, modern agronomic practices and to discuss the benefits of adopting the improved practices, including the potential to increase their incomes. Farmers who are reluctant to change their agronomic practices are more likely to pick them up after seeing the results displayed in demonstration plots. These plots also can lead to enhanced trust and stronger relationships between the company and outgrowers and if used effectively, they can lead to increased farmer productivity, another benefit for the company.

The company should use the question guide to address the following critical issues:

- Demonstration plot objectives
- Technical production practices and/or inputs to be used on the demonstration plot
- The number of demonstration plots and their size
- Location of the demonstration plots
- The role of the company in managing the demonstration plots
- The role of the farmer selected to cultivate the demonstration plot
- Compensation for the farmer who is cultivating the demonstration plot
- Using the demonstration plot to motivate farmers to adopt the improved production practices.

How the DO can support the company to address these issues:

- Lead the company through the thinking and planning process using the question guide
- Promote use of field days.

Cost-share options include:

- Costs incurred by the company in creating and cultivating demonstration plots on a declining basis.

Typical mistakes DOs make:

- Managing demonstration plots on behalf of the company
- Insisting on a particular production package that may not be feasible.

INTERVENTION BRIEF #13

Building the capacity of companies engaged in outgrowing to:
DEVELOP TRIAL PLOTS

Description of company initiatives the DO is supporting:
Companies use trial plots to experiment with new varieties and production methodologies. Trial plots differ from demonstration plots, which demonstrate proven practices that the company wants its outgrowers to use.

The company should use the question guide to address the following critical issues:

- Determine the purpose of the trial plots
- Determine who will manage the trial plots
- Determine the role of the farmers responsible for cultivating the trial plot if using that option
- Identify the information to be collected and the format for recording trial plot results
- Determine the role field agents play in supporting / managing the trial plots
- Choose the area to be used for the trial plots
- Determine the number of trial plots and their size
- Develop a work plan for establishing the trial plot(s).

How the DO can support the company in addressing these issues:

- Guide the company through thinking and planning trial plot development using the question guide
- Build company capacity to use trial plots to test new varieties and production techniques
- Organize international visits for companies to visit suppliers of seeds, inputs and/or equipment for testing on trial plots.

Cost-share options include:

- Trial plots on a declining basis (e.g. 70% first year, 50% second, 30% third, etc.)
- Technical specialists to advise / build company capacity to manage trial plots and effectively analyze results
- Exposure visits for companies to visit suppliers of seeds, inputs and/or equipment that could be tested on the trial plots (see *Intervention Brief #15*—**FACILITATE COMPANY VISITS TO SUCCESSFUL OUTGROWING OPERATIONS**).

Typical mistakes made by DOs:

- Becoming overly involved in direct management of the company trial plots. *This would hinder the ability of company to manage the plots sustainably on its own.*

INTERVENTION BRIEF #14

Building the capacity of companies engaged in outgrowing to:
DEVELOP MANAGEMENT INFORMATION SYSTEMS

Description of company initiatives the DO is supporting:
Companies require adequate management information systems (MIS) for their outgrowing operations, including tools and processes for record keeping, monitoring, and communication. Companies should develop an MIS that provides the essential information they need. They should not make the system complicated.

The company should use the question guide to address the following critical issues:

- Identify general types of data and information needed to manage the outgrowing operations
- Identify the users of data and information collected
- Develop information and reporting systems needed for:
  - Individual outgrowers
  - Lead farmers, if using an intermediary model
  - Input distribution
  - Monitoring field agent activities
  - Procurement operations
  - Measuring outgrower productivity
  - Other
- Develop systems to collect, manage and process information—computer applications, software, spreadsheets, manual registers, etc.

How the DO can support the company in addressing these issues

- Help the company think through the critical issues using the question guide
- Work with the company to determine the purpose(s) for which they need to collect information, who will use the information and the types of data they need to collect
- Work with the company to develop appropriate tools, including necessary software, and documents for monitoring production, outgrowers, procurement, field staff, etc.
- Expose company to sample forms and assist in adapting them
- Work with the company to improve information flows between management and field agents
- Expose company to outgrowing operation MIS that other companies use
- Prepare and conduct training for company staff in commonly-used registers and information systems
- Expose the company to industry standards and applicable buyer requirements as well as the types of information needed to comply with these standards.

Cost-share options include

- Costs for one-time consultancies by MIS experts can be cost-shared, but long-term staff costs should not be subsidized
- Exposure visits for company staff
- Training for field agents in use of registers and information systems.

Typical mistakes DOs make:

- DO supports development of a system that meets its own reporting needs, rather than those of the Company
- DO overburdens the company by attempting to include the its own information and reporting requirements into the company MIS
- DO evaluates company field staff performance and reports the information to Company management. *This can compromise trust between DO staff and field staff. The result could be difficult situations in which company field staff withhold problems and information and are reluctant to share their problems and mistakes with DO staff.*
- DO pressures the company to use the latest technologies, e.g. mobile phones, PDAs, bar coding, GIS, etc., which can be expensive and may be unnecessary to meet company needs.

INTERVENTION BRIEF #15

FACILITATE COMPANY EXPOSURE VISITS TO SUCCESSFUL OUTGROWING OPERATIONS

Exposure visits are used to introduce new and/or alternative ideas and methods of working to companies and can include observing successful outgrowing operations in other countries, participating in crop specific conferences, exploring sources of seed and equipment, etc. Seeing these activities and structures first hand can help the company design and implement a more efficient outgrowing operation.

How the DO can work with companies to organize an exposure visit
In many cases the DO can take a lead role in researching and organizing exposure visits for companies. This is justified because the visits are usually one-time activities that serve to build company knowledge and capacity so it can better implement its outgrowing operations. In some cases, a company may want and be able to organize its own visits and the DO can review and justify the objectives, share costs, etc. Regardless of the scenario, the following steps are important when planning and conducting a visit:

- Define the visit purpose and objectives
- Conduct research into potential sites and organizations to visit
- Contact potential sites and companies to arrange visits
- Determine an appropriate itinerary that is both educational and cost-effective
- Draft a contract, if necessary, with the hosting agents
- Coordinate the travel logistics
- Ask pertinent questions during the study tour to ensure objectives are being met
- Evaluate the exposure visit and establish a follow-up work plan for implementing new ideas triggered by the visit.

In many cases, particularly when several companies participate in a tour, it makes sense for a DO representative to accompany them and facilitate the visit and act as a guide. There may also be cases where it makes sense for lead farmers and/or outgrowers to participate with the Company to gain valuable experience and knowledge, especially insight into successful relationships and commercial arrangements between companies and outgrowers. In other cases, it can be very useful for companies to organize such exposure visits for their outgrowers to understand market dynamics, visit production facilities, etc.

Cost-share options include:

- Travel and applicable consultancy fees to hosting agents
- The possibility of paying for or contributing to costs such as airfare, local transportation, and accommodations, while the company can be responsible for visa applications, meals and incidentals, personal items, souvenirs, purchase of samples, etc.
- DO also can cost-share exposure visits organized by companies for their outgrowers.

Typical mistakes DOs make:

- Not including all relevant details in the MOU, especially details regarding who is responsible for paying what costs initially and how reimbursements are to be handled
- Requiring too little or no cost-sharing by the company. *This can lead participants to view the visit as a free trip rather than a learning opportunity*
- The DO cost-shares too little of the visit. *This can discourage participation by those who may not be able to afford to pay the full cost or who may not see the value of exploratory visits*
- DO allows company to send participants who are not key decision-makers. *In this case participants may be unable to follow through with implementing new ideas learned during the visit.*

Table of Appendices

THE FIELD SUPPORT PROGRAM

LEARNING ON OUTGROWING INITIATIVE

A CASE STUDY
ON
THE PEPSICO FRITO-LAY POTATO OUTGROWER PROGRAM INDIA

PRESENTED BY:

JILL MAJERUS

ACTION FOR ENTERPRISE

JUNE 2009

Table of Contents

Abbreviations

AFE	Action for Enterprise
AM	Assistant Managers
CF	Contract Farming
CFs	Contract Farmers
FA	Field Assistants
MoU	Memorandum of Understanding
MT	Metric Tons
NGO	Non-Governmental Organization

Executive Summary

PepsiCo Frito-Lay, a pioneer in the field of contract farming (CF), first established outgrowing operations in India in 1989. Although PepsiCo does not work with development organizations in support of its CF operations, its years of experience and the story of its India program provide many lessons learned and can serve as a model for other companies that may be thinking about developing CF operations.

Depending on the season, PepsiCo contracts up to 1,200 outgrowers / contract farmers (CFs) in order to procure more than 10,000 MT of potatoes for its chips factory (Lay's Potato Chips). To ensure the quality and quantity of supply needed, each year PepsiCo increases the benefits and incentives to farmers. At present, PepsiCo supports CFs by:

- Providing good quality seed
- Providing trainings and technical advice to improve yield
- Gathering soil samples and sending to chemical companies for analysis
- Organizing bulk purchase prices of fertilizers for farmers
- Linking farmers to bank loans with reduced interest rates
- Arranging appropriate chemical kits from a reputable company
- Orchestrating crop insurance for CFs
- Paying a fixed buy-back rate so farmers can easily calculate projected income for the season
- Providing farmers with a reliable, steady market
- Providing additional financial incentives.

PepsiCo feels that even if companies cannot provide such generous packages to CFs from the start, they should realize the importance of having strong relationships with farmers and building those relationships incrementally, starting simply with:

1. Training, *hand-holding* and technical assistance
2. Quality seed farmers can trust.

According to PepsiCo management, its outgrower operations are successful because of its ***relationship with the farmers*** with which it works. As described throughout this case, PepsiCo builds a relationship with each farmer by providing a series of benefits that include arranging loans for them and the provision of chemical kits and crop insurance in addition to affordable, good quality seed and technical assistance. Together, these benefits have resulted in a 30% increase in productivity, very few outgrowers who side-sell and many who provide the product quality and quantity that PepsiCo needs.

1. Introduction

The following is a case study of PepsiCo Frito-Lay and its potato outgrowing operations in Pune, India. The case provides an overview of the market and PepsiCo operations and looks at the organization's primary incentives for initiating and maintaining contracted outgrower relationships. The case also presents the key attributes that result in the continued success of its outgrower activities and the outstanding challenges that lie ahead for the company.

2. Description of PepsiCo Frito-Lay, Pune, India

Since entering India in 1989, PepsiCo has grown to become one of the nation's leading food and beverage companies. PepsiCo's food division, Frito-Lay, is the country's leader in the branded salty snack market. PepsiCo's three food processing and packaging plants manufacture Lay's Potato Chips, Cheetos, Uncle Chipps, Kurkure and Quaker Oats. The Frito-Lay India division employs over 48,000 people in India and generates over $1 billion USD in business.

PepsiCo has long been, and continues to be, a pioneer in the concept and implementation of CF, under which the company transfers agricultural best practices, inputs and technology to farmers. To guarantee quality inputs, particularly seed, PepsiCo established a 27-acre research and demonstration farm in Punjab, Northwestern India, to conduct trials of new varieties and produce seed for various crops. Under this program, PepsiCo has evaluated:

- Several varieties of basmati rice
- 25 varieties and hybrids of corn
- More than 60 varieties of peanut
- More than 100 varieties and hybrids of tomato
- Over 200 varieties of hybrid chili.

Regarding potatoes, PepsiCo has introduced six high-quality, high-yield varieties to more than 10,000 farmers working in over 10,000 acres across Punjab, U.P., Karnataka, Jharkand West Bengal, Kashmir and Pune, Maharashtra.

PepsiCo began CF operations in the Pune area in 2001, procuring just 50 MT. In 2008, its outgrower operations produced more than 10,000 MT. There are three seasons for potatoes—kharif (July-August sowing), late kharif (late sowing in September) and rabi (October-November sowing, irrigation required). The number of CFs varies from season to season (as do the conditions of their contracts). In kharif and rabi seasons, there are about 1,200-1,500 CFs while during late kharif there are only 200 CFs. Each farmer has an average of 1.5 to 2 acres, though some have as many as 12-15 acres. Currently, three potato varieties are grown in this region and yield is approximately 7.5-8 MT per acre. Three assistant managers (AMs) and eight field assistants (FAs) collaborate with 20 plus lead farmers (*Hundekaries*) on overseeing the Pune CF program.

3. Incentives for Outgrowing

PepsiCo sites one simple reason for procuring potatoes through CF—it ensures that quality potatoes are always available. PepsiCo outgrowers purchase premium quality seed that PepsiCo grows in its Punjab operations; this ensures the seed is pure with no mix in variety and is disease free. PepsiCo distributes this highly dependable seed to its farmers to assure its food processing and packaging plants receive both the quality and quantity of potatoes they need (quality seeds also result in better yields), another key to its success.

Sixty to seventy percent of the potatoes procured in Pune are from CFs, with the remainder procured on the local open market. In the near future, PepsiCo intends to move to procure 100% of its potatoes from CFs, particularly because the local open market quality is inferior and the price difference is not significant.

At the moment, PepsiCo is limited in its ability to increase its CF operations in the area due to the limited availability of its own quality seed. In 2003, PepsiCo estimated how much seed it would need, but its potato snack business has grown faster than projected and consequently now it does not have enough of its own seed for the greater than projected number of farmers it works with, forcing PepsiCo to purchase additional seed on the open market.

4. Structure of Outgrowing Operations

4.1. Organization

Management

As mentioned above, PepsiCo has three assistant managers, supervised by the General Manager of Operations who oversee CF operations. Eight field assistants, agro-consultants paid as contractors rather than as employees, support the AMs. The managers and FAs are responsible for 100 to 1,500 CFs at a time, depending on the season and they oversee and facilitate the procurement of 10,000 MT of potatoes per year. FAs are responsible for overseeing the fields of six to seven villages each.

PepsiCo Advice: Field assistants should have technical experience in potato cultivation and be able to train others effectively. If they are not very experienced, they should at least be from the growing area and know the local conditions and people. Train the field assistants—provide them opportunities to improve their skills and knowledge.

These AMs and FAs are responsible for:

- Projecting and suggesting the purchase price (i.e., buy-back rate) to upper management, basing projections on experience and expectations
- Selecting and signing contracts with outgrowers
- Distributing seed to farmers
- Training CFs both formally and informally throughout the season
- Monitoring fields and providing appropriate technical support
- Establishing procurement schedules and procuring potatoes
- Using on-site labs at the field office and factory to determine quality
- Overseeing procurement and payment processing for the CFs.

The AMs and FAs manage contract growing in two areas outside Pune—Sagao and Satara. They operate out of the field office in Sagao, PepsiCo's chips factory and operations site and occasionally from informal locations in Satara. PepsiCo uses field offices to distribute purchase orders to farmers and distribute seeds and laboratories are located at each field office to test the potatoes and determine quality.

Hundekaries – group leaders and knowledge transfer agents

A key to managing PepsiCo's outgrower program is the presence of hundekaries, lead farmers and/or intermediaries – some may not farm – who serve as group leaders and agents who transfer knowledge to farmers. One hundekari may work with up to 150 farmers, though most work with 10-15. About 20 hundekaries work with 1,500 farmers in the Sagao area during prime seasons.

Hundekaries coordinate procurement for which they receive a 9% commission per kilogram. To encourage group members to join them, a hundekari facilitates the transfer of knowledge from PepsiCo AMs and FAs, organizing logistics for PepsiCo's formal trainings, coordinating attendance by CFs and non-CFs, arranging for an appropriate venue and often providing tea at the occasion at their own expense. When organizing such group events and making field visits, hundekaries also work with non-CFs, recognizing this as an effective way to recruit more group members for the future.

In addition to receiving a procurement commission, hundekaries also receive a seed distribution incentive, usually 1% (or 0.05-0.10 rupees/kg). Some hundekaries have made this intermediary position quite profitable, for instance a lead farmer in Satara with 400 CF clients has worked with PepsiCo for three years and has employed four local assistants to help him service them.

4.2. Method of Selecting Outgrowers

Depending on the season, PepsiCo contracts with anywhere from 100 to 1,500 CFs per area (Sagao and Satara). On average each farmer has 1.5-2 acres though some may have up to 12-15 acres under cultivation.

PepsiCo selects CFs first by determining an appropriate area where soil and climate are conducive to growing potatoes profitably. Because yield is key to successful CF operations, these factors must be considered. Recent drought in some areas, including Satara, resulted in a severe reduction in the number of farmers contracted (from 1,200 CFs in 2007 to 118 in 2008).

> ***PepsiCo Advice:*** Start in areas where producers are already active and select a limited number of farmers. PepsiCo began in 2001 with 25 farmers and 58 acres under contract.

PepsiCo also recruits new CFs based on a referral system. Progressive farmers may suggest and/or select other farmers for inclusion in the program. In addition, PepsiCo has a strong reputation in the area, which attracts good farmers through word of mouth.

4.3. Procurement / Distribution of Seeds and Inputs to Farmers

As stated above, PepsiCo supplies all outgrowers with its own high-quality reliable seed, grown at its Punjab operation. The amount of seed produced is based on projections made five years ago when PepsiCo began cultivating its own seed. Now, however, the need is greater than the available seed and the company must purchase potatoes on the open market. Realizing that its CF operations provide the best quality potatoes, PepsiCo's goal is to become 100% reliant on CF for its potatoes.

> *PepsiCo Advice:* It is difficult for a small-scale operation to have its own seed program; developing one is a huge investment that can take 2-3 years to get going. It is not necessary to have your own seed program, but when working with existing seed producers, you need to ensure that they are reputable.

Initially, PepsiCo offered seed on credit, then on partial credit; eventually it required cash payment. PepsiCo advises others to begin by charging a premium to avoid side-selling of both seed and potatoes by CFs (5% of CFs side-sell seed).

Currently, CFs must pay-in-full when they receive the seed. To facilitate financing for CFs (and ensure payment for inputs sold to them), PepsiCo signed an MOU with the State Bank of India whereby the bank 1) makes loans to PepsiCo's CFs and 2) pays PepsiCo directly for seeds it sells to CFs by adding the cost to the farmer's loan.

PepsiCo distributes seed through field offices not far from farmers' fields; farmers transport the seed to their fields from that point.

4.4. Coaching / Training Contract Farmers

PepsiCo organizes two major trainings every year: 1) pre-sowing training (including seed handling and land preparations) and 2) pre-harvest training. PepsiCo staff find that visuals such as drawings and pictures are the most effective tools for training and trainers incorporate audio-visual presentations and banners into their trainings and sometimes post several signs around villages.

> *PepsiCo Advice:*
> 1) Training information should be specific and not too broad!
> 2) Design modules / training materials with lots of visuals!
> 3) Select the top three practices you want CFs to focus on, develop a training strategy and train them in these three points.
> 4) Don't just do company-mandated trainings; be open to impromptu trainings that address urgent issues on the spot—in other words, conduct needs-based training in the field!

PepsiCo develops some specific training materials for field staff to use in conducting their trainings and they also use training materials developed by the government and available on its website. Field staff adapts to changes and provides supplementary impromptu trainings to address pressing issues that farmers raise. They also encourage non-CFs to attend the trainings; PepsiCo views them as potential CFs and understands how a neighboring farmer's crop can affect the health of a CF's crop.

Package of Practices

PepsiCo has developed a series of technical practices – a *Package of Practices* – which AMs and FAs use in training CFs. There are more than 30 practices and each year the assistant managers and field assistants select from 3-10 key practices for farmers to focus on. Experience shows that only 30-50% of CFs follow what is taught in the trainings and PepsiCo encourages trainers to work with CFs on implementing just a few key practices at a time because trying to get farmers to learn and adopt many new practices at once is less likely to succeed.

Training topics include recognizing and treating diseases, managing pests, managing production costs, calculating expected loss, soil testing and both the wrong and right ways of doing things.

4.5. Technical Assistance / Monitoring of Contract Farmers

Not all training is formal and PepsiCo views the first training with farmers as an ice breaker and requires field assistants to then spend quality time in the field with them, providing support and building relationships.

PepsiCo Advice:

- You go to the farmer – get out into the field!
- Work with farmers on solutions to problems
- Remember—the farmer knows more than you do!

DuPont, an international input supply company with extensive operations in India, provides CFs with both *chemical kits* and training and technical assistance, as needed, particularly when chemical application is advised (see ***Chemicals for CFs*** in section **4.8. Incentives for Farmers**). PepsiCo field staff work hand-in-hand with the DuPont field staff to ensure CFs receive needed support throughout the season.

In addition to training, demonstration plots also play a vital role. According to PepsiCo, one of the most effective training methodologies is to have successful farmers tell their stories to others. PepsiCo emphasizes a strategy of supporting farmers through 50% visual training and 50% field assistance.

4.6. Contracting and Pricing Strategies

PepsiCo's standard outgrower contracts are specific to each season and are edited and signed annually by CFs. Due to the variability of the procurement price (buy-back rate), incentive packages, recommended chemical kits and whether farmers take a loan, PepsiCo does not engage in long-term contracts with CFs.

From May to June each year, AMs & FAs estimate the expected procurement rate and contract conditions, first calculating the expected costs of production for the season. For instance, a season that normally has less rainfall requires more irrigation, which increases cultivation costs.

In these instances, PepsiCo pays a higher buy-back rate to compensate for the increase in production costs (estimated at 25,000 rupees per acre in 2008).

Agents also calculate buy-back rates to encourage farmers to stagger their harvest dates in order to make the post-harvest procurement system more manageable; it also means that sowing dates must be included in the contract.

> *PepsiCo Advice:* If your objective in starting up a contract farming operation is to pay a lower price for product, you are doing it for the wrong reason! The goal should be to get quality potatoes and your buy-back rate should be set at or near market rates.

Field agents must take the market into consideration when calculating buy-back rates. This includes reflecting on the previous year's rate and projected market requirements. PepsiCo has learned that a price 10-20% lower than the market price can be acceptable to CFs as the growers see the value in the additional assistance PepsiCo provides as well as the high productivity of the seed they receive (additional incentives are described below). But, if there is a difference of 25% or more, the CFs may well be tempted to sell their potatoes on the open market, thus breaching their PepsiCo contract. In this case, the company may move the buy-back rate closer to the market rate or compensate through other incentives. At least once in the past, PepsiCo added 1.5 rupees per kilogram when the market price was significantly higher. Although it did not match the market price, it compensated for the significance in discrepancy. It should be noted that PepsiCo's package of benefits is exceptional relative to what smaller companies may be able to offer and a 20% deviation from market price often is acceptable to its CFs, where it would not be for CFs working with other companies.

PepsiCo insists that the buy-back rate be fixed in the contract with no mention in the contract that the rate is subject to change. This protects the company from disputes over market fluctuations and makes clear to farmers what they can expect to receive for their labor and investment. There is no wonder, fear or hope for what the market may or may not pay at the end of the season.

Contracts are signed for a period covering the duration of the season with each individual contract farmer. PepsiCo does not make agreements with group leaders though it does allow them with cooperatives.

PepsiCo also has a very strict policy regarding contract violations. The General Manager advises companies engaged in outgrowing operations to *be ruthless* when it comes to this issue. PepsiCo permanently black-lists anyone who is caught breaching their contract and side-selling their potatoes and there are no exceptions; approximately 3-4% of PepsiCo CFs side-sell during a given season.

In addition to the buy-back rate, the contract clearly lays out additional financial incentives for farmers (see section **4.8. Incentives for Farmers**); includes the standards potatoes must meet to be accepted and purchased and contains a letter of indemnity stating that the farmer will comply with the contract and not hold PepsiCo responsible for any loss. Another feature of the contract is an *Irrevocable Letter of Authority* allowing PepsiCo to make a direct payment to the CF's

bank following procurement of the potatoes, which enables the bank to deduct any loans made to the CF before depositing sales proceeds to an account.

4.7. Procurement operations

According to their contracts, outgrowers bring their harvest to the field office and/or designated stations for grading and sale. Until the lot has been properly assessed (graded and tested) and the proper paperwork has been signed and handed to the outgrower, the lot remains in the possession of the outgrower. Once PepsiCo takes ownership at the field office, the company then takes responsibility for transporting the produce to the factory near Pune.

PepsiCo conducts tests on samples from CFs' harvests to evaluate potato dimensions, disease, defects, dry matter and sugar content and asses them against the contract standards. PepsiCo rejects potato lots not meeting these standards and does not purchase them. For lots it purchases, PepsiCo requires 15 days to process payment from the procurement date. For CFs with loans, the payment is made by wire transfer directly to the bank, which immediately recoups its loan and interest (as per the MOU with PepsiCo).

4.8. Incentives for farmers

CFs cite numerous reasons for working with PepsiCo, which:

- Provides good quality seed
- Provides trainings and technical advice to improve yield
- Gathers soil samples and sends to chemical companies for analysis
- Organizes bulk purchase prices of fertilizers for farmers. PepsiCo buys fertilizers in bulk and resells to CFs at basically the same rate it purchased them
- Links farmers to bank loans with reduced interest rates
- Arranges appropriate chemical kits from a reputed company
- Orchestrates crop insurance for CFs
- Provides additional financial incentives for farmers following PepsiCo's Package of Practices (see training section below for description).

Loans to CFs

Since 2006, PepsiCo has signed an annual MOU with the State Bank of India where the bank agrees to provide loans to PepsiCo CFs under terms and conditions negotiated with the company. The agreement, arranged between the corporate offices of the bank and PepsiCo, can be terminated with 30 days notice. The premise of the agreement is that PepsiCo agrees to make a direct payment to the bank following procurement of the potatoes if the bank gives a loan to the farmers. This allows the bank to automatically recover any loans made to PepsiCo CFs, so long as the CFs sell their potatoes to PepsiCo as agreed in their contract.

The MOU details the amount of the loan per acre and clearly states that the money goes to the individual farmer only and not to a hundekari or other middleman. To get the loan, as per the MOU, CFs simply show a record of land ownership and write personal declarations that they owe no money to other banks in India. The MOU also states that if an outgrower takes a loan, s/he is required to get crop insurance, seeds and the chemical kit PepsiCo recommends. This

benefits both PepsiCo and the bank because it ensures that farmers have the inputs and insurance they need to provide quality potatoes and not default on their loans. The MOU further states that upon immediate disbursement of loans to farmers' accounts, payments due to the following companies will be automatically withdrawn and electronically transferred to the respective companies' accounts:

a) PepsiCo for seed
b) the insurance company for crop insurance
c) the chemical company for pesticides.

Farmers can withdraw only the remaining funds for labor and other farm costs.

The bank benefits because PepsiCo not only brings in thousands of clients, it also does marketing and, quite frequently, the necessary paperwork as well. The local branch had 1,200 PepsiCo CFs the previous year with an average of 95% of PepsiCo CFs taking loans with their bank. The Hundekaries also play a role by handling most of the paperwork with the farmers, so the bank branches do not have to deal with each individual farmer even though bank accounts are in individual names. The State Bank of India has reported low default rates because of this agreement (5% average) and those who do default are denied a loan the following year.

Farmers not associated with PepsiCo usually must borrow from a local money lender and pay much higher interest rates and if they take a loan at the bank, they must provide more paperwork, including proof from all other banks in the area (with official stamps) proving that they do not owe them. If they are successful in securing a bank loan, the interest rate is 11% and they can borrow only 18,000 rupees per acre. Under the PepsiCo / State Bank of India agreement, CFs get an interest rate locked in at 7%, can borrow up to 25,000 rupees per acre, and can self-declare themselves debt-free for loans of up to 50,000 rupees.

The terms of the MOU between PepsiCo and the bank are revised annually to adjust to changing production costs. In the future, PepsiCo plans to work with the bank to provide ATMs in rural areas to make funds and payments even more accessible for CFs.

Chemicals for CFs

PepsiCo also has an agreement with DuPont to provide:

1) Chemical kits (pesticides, insecticides, etc.) to CFs per PepsiCo requirements
2) Services and equipment embedded in the cost of chemical kits that includes staff for trainings and field visits, protective clothing for farmers and sprayers / nozzles (in the past, DuPont provided one power sprayer good for three years of use for every 200 CFs).

PepsiCo determines the contents of chemical kits and price annually. Kit contents vary from season to season and location to location and are based on historical experience, some trial and error and field representative suggestions. Mite-treatment chemicals are included because it is better to risk paying for unused chemicals to ensure they are on-hand if needed since the window of opportunity to treat the mites is small. In 2008, it the kits contained twelve items.

Although the kits also contain some products DuPont does not make, its MOU with PepsiCo states that DuPont is responsible for negotiating the inclusion of these other products into their kits.

CFs who take a bank loan (95%) are required to purchase the DuPont chemical kit. The remaining 5% are not required to purchase the kit, but are strongly encouraged to do so. If farmers buy chemicals on their own, they usually pay 10-15% more for the same products. As farmers are price sensitive, PepsiCo aims to create a kit that is appropriate for farmers' needs. If they include too much, which increases the cost, CFs may not want to buy it or may cut costs by not applying products or purchasing poorer quality chemicals at a lower price and reselling the kits they are required to buy. In addition to the basic DuPont kit, CFs may need to purchase other chemicals in the marketplace.

DuPont Advice: In addition to chemical kits, services are essential and chemical companies should take responsibility for proper application of their products to ensure a good yield. Also key is continuous communication with farmers—regular field visits, especially during chemical application is critical. Farmers don't really care if you come to their fields if they are not having problems, but if they are having problems, they are extremely sensitive if you do not visit.

By partnering with PepsiCo in this way, DuPont is ensured a customer base of approximately 3,000 farmers each year. Thirty-five percent of DuPont's sales are through the chemical kits to PepsiCo CFs; the other 65% are through retail shops. DuPont benefits greatly from these chemical kit sales because with retailers there often is a credit system and it can be difficult to collect payment.

Free training and field visits by DuPont technical staff are included in the purchase of chemical kits. DuPont recognizes that relationships with farmers are extremely important for them as it affects retail sales when additional chemicals are needed. Visiting PepsiCo CFs' fields also builds DuPont's reputation among non-CFs. DuPont usually provides two formal trainings per season with agents making field visits, particularly if there are problems. DuPont also organizes trial / demonstration plots for its new products and hundekaries help set up field meetings / trainings for DuPont agents. PepsiCo provides DuPont with the entire CFs database so it can follow-up with farmers directly, although they usually work together. One DuPont field agent manager may have 50-60 farmers in two to three villages to visit, while regular field agents might service 150-200 farmers in a season. They see the same farmer every five to six days.

A challenge DuPont faces is that CFs expect chemical kits to be sufficient for all their farming needs in a season. Under normal circumstances they are, but fluctuations in weather or diseases can mean more chemicals are sometimes necessary. Additionally, if CFs do not get the results they want following the trainings, they can get upset. As DuPont agents cannot be there for all applications to ensure farmers are following the practices taught in the training, the relationship with farmers can be strained. Despite these challenges, PepsiCo, DuPont and the CFs all benefit from these agreements.

Insurance for CFs

PepsiCo also negotiates crop insurance for its CFs. As stipulated in the MOU between the insurance company and PepsiCo, the insurance company generally reimburses the cost of lost production so the farmers do not lose money spent. The average premium is set at 900 rupees per acre and for CFs who opt for a loan, their bank pays the insurance company upon disbursement

of the loan. Although CFs who do not take loans are not obliged to buy insurance, approximately 99% of CFs get the insurance, including those who do not take loans.

Additional financial incentives for farmers

Financial incentives for farmers are established at the time of contracting and occasionally just before harvest. These financial incentives are established to motivate farmers to continue positive behaviors and discourage negative practices. Incentive packages can vary year to year and may depend on the length of time outgrowers have been engaged in contract farming with PepsiCo. For example, in the first year, a new outgrower will receive a financial incentive to encourage the use of the chemical kits. Other incentives offered to all farmers, such as those based on the number of kilograms with a high solid (dry matter) percentage or high purity (minimal defects). There typically is a *Loyalty Incentive* for farmers who contract for two to three years or more. All incentives are based on per kilogram amounts (not lump sums).

In the past, PepsiCo provided incentives based on a multiplication ratio (increase in yield per acre), but discontinued this incentive as farmers found ways to cheat on the measurements to ensure higher payouts. Disincentives for CFs are limited to the attraction of a potentially higher market price on the open market, especially when loans must be repaid. To reduce the temptation to sell on the open market, PepsiCo ensures CFs understand the long-term ramifications, including through permanent black-listing of those caught breaching contracts by side-selling.

5. Fundamentals of Success

According to PepsiCo management, the number one reason its outgrower operations are so successful is its ***relationships with the farmers***. As described throughout this case, PepsiCo builds its relationships with individual farmers by providing benefits such as arranging loans, chemical kits and crop insurance to providing affordable, high quality seed and technical assistance that result in a 30% increase in productivity. In return for these perks, few outgrowers side-sell and most provide the quality and quantity of produce that PepsiCo needs.

6. Biggest Challenges

Having overcome numerous challenges through the years, PepsiCo is well positioned to move into the future. Currently, the primary challenges lie mostly in rising fertilizer costs, drought and the need for better crop insurance, all of which can lead farmers to default on their contracts and produce insufficient quantity and quality potatoes.

Recent droughts have forced PepsiCo to reduce the number of farmers in the Satara area and it now works with just one in ten of the farmers they contracted with in the past. Normally, there are 1,200 CFs in the area, but in 2008 PepsiCo cut the number to 118. Urban encroachment also is becoming a problem, as farmlands are converted to industrial, business and residential use.

The government is providing additional challenges, recently writing off all debt nationwide for farmers who think the government will do the same in another three to five years. One outcome of these actions is that farmers are more likely to default on their loans and side-sell PepsiCo seed and potatoes.

THE FIELD SUPPORT PROGRAM

LEARNING ON OUTGROWING INITIATIVE

A CASE STUDY
ON
MULTIFLOWER FLOWER SEED OUTGROWER OPERATIONS TANZANIA

PRESENTED BY:
HENRI VAN DER LAND (MMA LTD)

ACTION FOR ENTERPRISE
NOVEMBER 2008

Table of Contents

Abbreviations

AFE	Action for Enterprise
CF	Contract Farming
FO	Field Officer
MF	MultiFlower
MMA	Match Maker Associates
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization

Executive Summary

Action for Enterprise (AFE) contracted Match Maker Associates (MMA), a consultancy and training firm based in Tanzania, to develop a case study on MultiFlower Ltd. (MF) to document 1) best practices for successful organization of outgrowing operations and 2) experiences and lessons learned on how development programs can best facilitate mutually beneficial outgrowing operations between agribusiness companies and farmers.

MF began small-scale production of flower seeds for Dutch buyers in 1996, initially producing seeds on the founder's small shamba (field) and those of a few outgrowers. Since then, MF has increased its turnover from approximately €80,000 in 1996 to €800,000 in 2007 when it employed 18 staff and contracted with more than 2,000 outgrowers. MF exports a wide variety of flower seeds with the most common sub-divided into five groups—marigold, zinnia, cosmos, ipomea and sunflower. MF currently contracts all flower seed production to around 2,400 smallholder farmers producing about 200 tons of seed on approximately 2,000 acres (650 hectares). MF produces the seeds for eleven clients in the Netherlands, France, Great Britain and Germany who provide the seed stock.

Each variety of flower seed has its own ideal micro climate (altitude, temperature, etc.) and MF benefits from the diversity of micro climates around Mount Meru and Mount Kilimanjaro by engaging outgrowers. Smallholders cultivating widespread, isolated plots that avoid cross pollination have a clear comparative advantage when compared with estate farms and they help MF achieve a 98% standard of seed purity.

Field officers (FOs) are the hub of MF's field operations and supporting them are *contact* or *lead farmers* – trusted, usually progressive farmers who help the FOs and coordinate with individual outgrowers. The number of outgrowers an FO works with may range from a minimum of 150 farmers to a maximum of 350 with the average being around 200 outgrowers. The amount of work they need to do depends on the number of lead farmers in their area. Experienced lead farmers assist FOs with seed distribution and provide advice to farmers on land preparation, planting, harvesting and cleaning. An interesting feature of MF outgrowing operations is that lead farmer payment is performance-based—if operations go well they can receive significant bonuses.

Most outgrowers have at least two seed varieties in their fields—a common variety and one that is more specialized. The buyer and MF negotiate the purchase price of flower seeds and then MF determines the outgrowers' price per variety. When a certain variety proves difficult to grow, MF may request a higher price from the buyer and then raise the price for outgrowers. On average, farmers receive around 50% of the FOB[5] price. It is important to note that contracts are between MF and individual farmers and are renewed annually. The contracts are standard and have the same conditions for every grower.

[5] Free On Board: A shipping term which indicates that the supplier pays the shipping costs up to the point of shipment: ex. seeds shipped f.o.b. Dar es Salaam. *Source: www.businessdictionary.com*

Only a few farmers require inputs other than seed. MF estimates that about 10% of farmers need to apply a fertilizer, e.g. UREA and only 3% have to use pesticides and fungicides. MF purchases fertilizer and pesticides in bulk and issues them to the small number of farmers in need through an arrangement in which the cost is deducted from the farmer's final payment.

The main incentives for farmers to join the MF outgrowing scheme are the attractiveness of flower seed as a cash crop and a secured market. In addition, they can increase their margin by expanding the area under cultivation and producing higher value seeds.

According to MF, the success of its flower seed outgrowing scheme is due to:

- A very close and transparent relationship with its overseas buyers
- Its reputation among farmers as a reliable and competent company
- Its hands-on, professional extension services
- Opportunities for farmers to increase their income over time
- Extremely committed and competent owners, managers, supervisors and administrative staff.

Its biggest challenges are:

- Pre-cleaning and adequate storage of seeds at farm level
- Increasing productivity
- Improving storage facilities and cash flow to store seeds at MF level
- Production of its own seed stock
- Lack of mechanized cleaning at central / factory level.

For several years, MF engaged FAIDA, an NGO based in Arusha, to help it identify reliable farmers and promote the firm in areas where it wanted to expand operations. As MF became familiar with an area and the farmers there, FAIDA's role diminished accordingly. In addition to farmer identification and promotion of MF, FAIDA provided a broad range of technical support services, including support in locating selecting and mobilizing farmers, facilitating meetings and contract negotiations between MF and outgrowers, training farmers in business skills, organizing exchange visits and setting up collection centers. MF and FAIDA continue working together on specific issues, e.g. side-selling.

A jointly developed *crop calendar* that planned all activities for both parties from *seed to seed* greatly strengthened the collaboration between MF and FAIDA. Though there was also an MOU that described the roles of each party, the crop calendar laid out a schedule that detailed critical timing issues and enabled both parties to hold each other accountable.

1. Introduction

Action for Enterprise (AFE) contracted Match Maker Associates (MMA), a consultancy and training firm based in Tanzania, to develop a case study on MultiFlower (MF) to document 1) best practices for successful organization of outgrowing operations and 2) experiences and lessons learned on how development programs can best facilitate mutually beneficial outgrowing operations between agribusiness companies and farmers. In developing the study, MMA conducted interviews with various individuals and groups, including:

- MF management
- MF representatives responsible for field operations
- Field-level staff and/or suppliers
- Farmers
- Development organization staff.

As MMA validated the information it obtained by sharing it with the different parties engaged in the operation, the data, particularly the lessons-learned, provide a true picture of the complexities of MF's outgrowing operations.

2. Description of MultiFlower

MultiFlower (MF) began with the production of flower seeds in 1996 on a small field close to the founder / owner's home and a small number of outgrowers. The only field officer at that time was the owner who remains the majority shareholder. Since then, MF has increased its turnover from around € 80,000 in 1996 to € 800,000 in 2007. Presently, MF employs ten field officers, two administrators, three storekeepers, two individuals to conduct trials and a department manager. MF exports a wide variety of flower seeds, but the most common are divided into five main groups:

- Marigold
- Zinnia
- Cosmos
- Ipomea
- Sunflower.

All flower seed production is contracted to smallholder farmers, currently around 2,400, producing about 200 tons of seed on approximately 2,000 acres (650 hectares).

MF exports flower seed and also engages smallholders to produce vegetable seed which it distributes throughout Tanzania. Staff at the MF central cleaning and storage facility in Arusha work part time for the flower seed business and MF management and support departments – finance, human resource management and logistics – divide their time between MF and its sister companies, Greenstars and Arusha Cuttings.

MF produces flower seeds for eleven clients in the Netherlands, France, Great Britain and Germany who provide the seed stock. The increase in orders in recent years is due partly to flower seed companies that used to get seeds from China once again ordering seed from Africa.

The increasing cost of production in China, particularly for labor, and the tampering with patent rights is making some buyers wary of continuing to source from China.

3. Incentives for Outgrowing

Each variety of flower seed has its own ideal micro climate, e.g. altitude and temperature, and by engaging outgrowers, MF can benefit from the diversity of micro climates around Mount Meru and Mount Kilimanjaro. Moreover, plots that are widespread and isolated help to avoid cross pollination and enable producers to achieve a high purity standard of 98%. This gives smallholders a clear comparative advantage over estate-farmed flower seeds. Though it is possible to make estate farming work, as shown by companies such as Manyara Estate, cleaning is very labor intensive and it is difficult to make the business profitable. Most outgrowers allocate only part of their farm to flower seed production, typically about 80% or 1 to 1.5 acres (on the lower side there are farmers with 0.5 acres and on the higher side some farmers may go up to 6 acres). Combining flower seed production with that of food and cash crops spreads the risk for farmers and helps ensure their food security.

4. Structure of Outgrowing Operations

4.1. Organization

A female manager, assisted by a female deputy manager, is responsible for MF's flower seed contract farming (CF) operations. Currently, MF employs nine male field officers (FOs) and one field supervisor. With the exception of the supervisor, field officers do not hold a degree in agriculture; they are, however, highly experienced farmers. The FOs report to the supervisor every morning to plan activities for that day – or for several days if they must travel a long distance. In addition, they meet with the supervisor and management every other Saturday morning to discuss progress and issues and learn together. The supervisor compiles information provided by field officers and prepares weekly reports for management.

The deputy manager's prime responsibility is to oversee and monitor field operations while the manager consolidates all data, prepares reports for company management and maintains contact with the buyers. The latter is critical as buyers want to be kept updated of the situation in the field, particularly the anticipated output of their ordered varieties. Also, the manager informs buyers, who also supply stock seed, of any non-performance of seed or other factors that affect its production. It is interesting to note that even though company management is responsible for client relationships, MF also provides clients a direct line of communication with its operational managers.

The FOs are at the center of MF's field operations; they are supported by trusted *contact* or *lead farmers*, who help the FO and coordinate with individual farmers. Each FOs is responsible for a certain region during the entire growing season and when MF receives orders from buyers in January-March, it divides them amongst the FOs, taking climate, elevation, soil, etc. into account. The buyers then send their stock seed for distribution to the farmers. MF also produces some stock seed, which clients accept only if it meets high varietal and quality standards. As

farmers usually demand more seed than is allocated, the FO must decide who is growing what and how much.

Most outgrowers have at least two seed varieties in their fields – a common variety and one that is more specialized. MF first negotiates the prices with the buyer and then decides outgrowers' price per variety. Though farmers' prices are not negotiable, when a certain variety turns out to be difficult to grow, MF may request a higher price from the buyer and if the client approves, also raise the outgrowers' price. It is important to note that contracts are between MF and individual farmers and are renewed annually. The contracts are standard and, *except for price differences for each variety and the amount of seeds to be produced*, they contain the same conditions for every grower. Prior to planting, MF organizes a seminar with all farmers to assess the prior year's performance, discuss production issues, review contract issues and plan ahead.

The number of outgrowers a FO works with varies substantially—from a minimum of 150 farmers to a maximum of 350. The average is about 200 farmers. During the peak season (March – June) the FOs visit an average of 20 farmers / day. FOs use motorbikes that MF provides and often stay overnight in an area. The amount of time they spend in an area depends on the number of lead farmers available to help them.

Lead farmer selection occurs in two stages 1) MF develops a shortlist of potential candidates in an area and 2) farmers choose one of them as their lead farmer. The lead farmer assists FOs distribute seed and provides advice throughout the growing season on topics such as land preparation, planting, harvesting and cleaning. Lead farmers also communicate with FOs about any production issues and inform farmers of follow-up visits by FOs. An interesting feature of the MF program is that lead farmer payment is performance-based. If field preparation and seed distribution meet MF performance criteria, lead farmers receive TShs 40,000 (US $32) [6]. Adequate supervision of production, harvesting and cleaning as judged by agreed-upon indicators, earns them another TShs 85,000 (US $67) earning them a total of TShs 125,000 per season or about US $100. MF reimburses operational costs such as travelling to HQ to deliver monthly reports or the collection and distribution of seeds on an actual-cost basis.

In general, lead farmers and FOs provide individual outgrowers with advice and support rather than using demonstration plots. Instead they advise farmers to visit neighbors experienced in flower seed production to learn from them. Should problems such as diseases arise, lead farmers communicate with the FO (via mobile telephone) who then attends to the problem. If problems cannot be resolved on the spot, the FO takes digital photographs to share with the field supervisor and management. FOs also request advice from MF's buyers and transmit the photos to them.

4.2. Method of Selecting Outgrowers

The way MF mobilizes and selects farmers has evolved over time. Initially, and when opening a new area, MF and sometimes local NGOs, promoted the new cash crop. After farmers in an area became familiar with flower seed production, MF reacted to requests to participate in its

[6] $1 = 1.26 Tanzanian shillings (Oct 2008)

outgrowing operations, choosing farmers with an established reputation. Expanding the production capacity of existing outgrowers is responsible for 70% of the annual growth in MF flower seed production—newcomers whom lead farmers identify and recommend account for the remaining 30%. There are many advantages to working with farmers already proven to be productive and reliable, including increasing the number of farmers FOs can work with and controlling costs because they do not require the same amount of support and attention as less experienced newcomers. There is a financial incentive for FOs to engage farmers with the proven ability to deliver according to the contract because their salary is based partly on results. FO bonuses depend on the production of flower seeds and fulfillment of buyers' orders as well as total production in their area. Normally, a bonus of one to three months pay is added to their salary incrementally during the year with final payment at year-end.

4.3. Procurement / Distribution of Seeds and Inputs to Farmers

MF signs contracts with farmers in January-February and distributes seeds as soon as possible thereafter. Previously, MF's buyers provided the stock seed for *free*, but due to frequently late deliveries, MF negotiated with some clients the right to produce and retain stock seeds – except for hybrids – particularly marigold and sunflower. MF produces the stock seed on its own farms in Arusha and Moshi, outsourcing some production to selected outgrowers. It also uses the same to test for quality, including germination rate, determination of growing patterns and habits, comparison of locally-produced seed with imported seed and, ultimately, seed selection.

Only a few farmers require inputs other than seed. MF estimates that around 10% of farmers must apply fertilizer like UREA and only 3% need to use pesticides or fungicides. MF buys fertilizer and pesticides in bulk and issues them to farmers in need of these inputs, deducting the cost from their final payment, which saves farmers from having to rely on local suppliers for their inputs. The FO provides technical support to farmers, from land preparation to harvesting through farm visits and hands-on advice. During critical times like harvesting, the FO stays in a village for several days to ensure activities are done correctly. Harvesting is the most labor intensive of all activities in the production cycle; it must to be done by hand and most farmers hire casual laborers to assist them. The flower seed outgrowing scheme provides substantial employment; a rough estimate is that outgrowers engage approximately 10,000 casual laborers, or 10 to 20 person-days each per production cycle. Following harvest, seed must be dried and cleaned and the protocol and method differ for each variety. The primary criteria for clean, dry seed are that they should contain less than 10% dirt and have less than 8% humidity.

In its flower seed outgrowing scheme, MF does not promote linkages with input supply companies; it supplies the stock seed and when needed, chemicals and fertilizer. MF provides these inputs on credit and deducts the cost from the crop receipts so no external financing is required. Harvesting and cleaning are the most labor intensive activities, but as most farmers have small plots they usually manage with family labor. For farmers with larger plots and capital constraints at time of harvesting, MF is willing to assist well-known, trusted farmers with an advance on the crop payment so they can hire casual labor.

As mentioned earlier the prices per variety are set by MF. On average, the farmers are receiving around 50% of the FOB price[7]. The seed has to be clean and it has to meet the germination and purity requirements (respectively 97 and 98%). Verification of cleanliness, purity and germination is done at the MF warehouse (go-down) and due to the fact that it takes time to test the seed on its qualities, farmers are paid three months after delivery. Farmers are responsible for the delivery of the seed to the go-down. All other logistics including sorting, cleaning, testing, packing and shipping are the responsibility of MF. It should be noted that MF is normally paid four months after having paid the farmers as the buyers also wish to test if the seed complies with the quality parameters before payment. In spite of not having a credit policy, MF occasionally provides pre-payment to their well known and reputable farmers but never more than 10% of their crop value.

The main incentives for farmers to join the outgrower scheme are the attractiveness of flower seed as a cash crop and the secured market. They also have an opportunity to grow by expanding the area of flower seed under cultivation and producing high-value flower seeds that provide a higher return. MF selects only well-performing farmers to cultivate more complicated high-value flower seeds, particularly hybrid seeds requiring a greater level of effort in weeding, rouging and pollinating.

5. Fundamentals of Success

The success factors for the flower seed outgrowing scheme are:

- MF has a very close and transparent relationship with its international buyers. They know MF tries its best to provide timely delivery of quality seed in accordance with contract specifications and they understand the challenges of producing flower seed in Tanzania with smallholders—they have visited the farms. MF also provides regular progress reports and updates them if certain problems occur. The result is a high level of mutual trust between MF and buyers.
- Farmers know MF is a reliable and competent company that is accountable and transparent in its dealings with them. Farmers understand that contract conditions must be strictly adhered to and MF will ban those who engage in side-selling for life; however, there is no exclusivity clause in the contract and farmers can sell flower seed not grown under contract by MF to others. They also can decide annually if they wish to renew their contract with MF and can either drop it or enter into a contract with another company.
- MF's hands-on and professional extension services greatly contribute to the success of the scheme. Farmers are not left on their own and receive significant support and coaching from FOs to achieve their contractually-agreed outputs. The fact that FO remuneration is partially result-based definitely makes them highly committed and ensures they strive to achieve their targets as doing so can double their salaries.
- The opportunities for farmers to increase their income through flower seed production either by increasing the area under cultivation and/or growing higher value, more complicated flower seeds also adds to farmer commitment and success of the scheme.

[7] Free On Board: A shipping term which indicates that the supplier pays the shipping costs up to the point of shipment: ex. seeds shipped f.o.b. Dar es Salaam. *Source:* *www.businessdictionary.com*

Such opportunities stimulate ambitious, business-minded farmers and result in reliable and competent suppliers.

- The extremely committed and competent owners, managers, supervisors and administrative staff of MF definitely contribute to its success. The entrepreneurial drive of the founder / owner has never ceased and, even though the day-to-day management of the company is now done by others, he is available 24/7 to advise and coach. Though he moved back to the Netherlands five years ago to be closer to the market and buyers, he makes at least ten trips yearly to take care of his business interests, including MF. The general manager is committed and knowledgeable and continues to strengthen the approach introduced by the owner of building the capacity of the Tanzanian middle managers, technicians and supporting staff. Company protocols, administrative systems and reporting procedures continue to enable and support FOs in their role as the core of the MF outgrowing scheme.

6. Biggest Challenges

There are a number of challenges, such as:

- *Pre-cleaning and adequate storage at farm level*: MF can increase efficiency and cost-effectiveness if cleaning and sorting of flower seeds is at the farm level. This requires an investment in tarpaulins for proper drying and sieves for cleaning. Investments in adequate village storage facilities are essential to maintain quality.

- *Increased productivity:* proper land tillage, particularly deep ripping to 70 cm of the land could increase yield per acre and farmers' incomes substantially. This requires that farmers have access to reliable and affordable ripping by tractor, of at least 100 horsepower. Another firm already promotes this for safflower production and MF could replicate it.

- *Improved storage facilities and cash flow for MF to store seeds*: due to a lack of appropriate storage facilities and cash flow constraints MF must sell its excess production of flower seed to buyers at a discounted price. MF actually suffers twice because in addition to lower prices for excess seed, orders the following year may decline as buyers have sufficient stock, which they are able to store. A climate-controlled storage would enable MF to store seeds at maximum 15ºC and, rather than dumping them, keep them for the next season when it could ensure timely delivery and have sufficient seed for production.

- *Production of own stock seed:* MF is already doing this, but it would like to increase the scale of this production to 80% of its requirements. The buyers support this development and it is likely to be achieved in the coming years assuming it can properly store the seed.

- *Mechanized cleaning at central/factory level*: a machine for cleaning the seeds has been procured but still has to be installed. Delivery of clean and even better vacuum sealed seed will increase value by 5 to 10% and also reduce the rejection percentage (presently around 5 to 10%).

7. Role of Development Organization—MF Perspective

MF has received support from FAIDA MaLi (FAIDA), a local NGO, that has helped introduce the company in villages where it was not known and flower seed as a cash crop was a new activity. FAIDA seminars that enabled farmers to understand the cost / benefit and risks of producing flower seeds and compare it with other cash crops were especially instrumental in promoting the scheme. FAIDA also played an important role during contract negotiations by explaining the terms and conditions. Since it was an outsider and not part of the company, FAIDA was able to address many outgrower concerns and fears. According to MF, FAIDA's most important contributions were its promotion of them in new areas and identification of reliable farmers. Once MF was familiar with the area and the farmers, FAIDA's work was done. The MOU MF signed with the NGO for expansion into a new area was for a maximum for two years and sometimes only for one. Following this period, MF continued on its own (as described in section 4, above) though it has asked the NGO for assistance when specific problems occur, particularly side-selling.

The challenge for the NGO is to exit in a timely fashion and not assume tasks and responsibilities that belong to the private sector. The NGO must avoid free hand-outs and not pamper farmers, e.g. by transporting their produce. There is always a bit of sensitivity between NGO and company field staffs because NGO employees often have higher salaries and better working conditions than company staff. Moreover, NGO staff has a tendency to make promises and commitments to farmers that the company cannot honor.

NGOs or projects can play a major role in providing baseline data, particularly about soil fertility through soil sampling. They could help mobilize resources for essential activities like soil ripping.

8. Role of Development Organization—FAIDA Perspective

8.1. Company Selection and Establishing Credibility

The relationship between FAIDA and MF has a long history, beginning in 1997 when FAIDA was an SNV (Netherlands Development Organization) project and the coordinator met regularly with the MF owner. Collaboration between FAIDA and MF evolved from these meetings. The main criterion for FAIDA to engage with MF was the potential for smallholder farmers to generate income. Because plots for flower seed production are usually small and often close to the home, the MF outgrowing operation was particularly attractive for female farmers and an additional factor that made FAIDA enthusiastic about mobilizing outgrowers for the company. SNV did not formally assess the company, but due to the Dutch connection between the two entities, it had a good understanding of the owner's entrepreneurial abilities and the viability of the company. At that time, MF was the only company in Tanzania producing flower seed; a competitor emerged only in 2006.

The MOU between FAIDA and MF clear states the roles and responsibilities of both parties. FAIDA would not assist MF with assessing market demand, accessing markets or determining the feasibility of the outgrowing operations—the owner of MF was very well connected with the

Dutch buyers and he knew both the margins in the trade as well as the competition. The types of support FAIDA offered evolved over time based on its ongoing collaboration with MF.

8.2. Managing Collaboration

The joint development of a *crop calendar* that planned out all of the outgrowing activities from *seed to seed* greatly strengthened the collaboration between MF and FAIDA. The calendar helped clarify the role of each party – as described in the MOU – but more importantly it provided a timeline for the different activities that each party could follow. It also enabled both parties to hold each other accountable and it facilitated the interaction of the staffs of both organizations, particularly at the field level, because they knew what activities they needed to undertake either by themselves or together – and when. The crop calendar also allowed MF and FAIDA staffs to carry out activities without seeking approval from supervisors. The top MF and FAIDA managers were involved mainly in developing the MOU and addressing problems their field staffs could not resolve.

During the first years of the outgrowing operations, there was a dependency by both MF and the farmers on FAIDA. As mentioned earlier, FAIDA performed a broad range of services considered critical at the initial stage of the scheme. Initial distrust of the company by the farmers also contributed to a dependency on FAIDA. Another factor that fostered dependency by both MF and the farmers was the *area-based approach* that FAIDA followed. Under this approach, FAIDA based field staff in each selected location, while MF field officers were based out of Arusha head office and visited the field only periodically for specific activities. This initial dependency on FAIDA increased in time of crisis, e.g. when seed did not perform or when there were problems during rouging (the process of removing diseased plants) and harvesting. In these situations both MF and the farmers relied on FAIDA to resolve the problems! In some instances FAIDA even went to the extent of providing allowances to the MF FOs so they could visit problem areas or buy some sieves to address cleaning issues. Such interventions went beyond the scope of the MOU and did not allow MF and its contracted farmers to resolve the issues together. This may have delayed the development of a mature relationship between the company and its outgrowers.

Maintaining positive collaboration was always a challenge for MF and FAIDA. From 1997 until 2001 the relationship was positive even though there were some ups and downs during that period. After 2001, however, the relationship became more problematic and it halted completely from 2002 until 2006. Various factors contributed to a cessation of the relationship, including:

- The new FAIDA coordinator did not have the same rapport with the owner of MF as the former coordinator did and it became more difficult to work out differences
- An MF buyer supported the MF flower seed supervisor in starting up her own flower seed company and MF lost a substantial share of the market
- FAIDA had just started a mobilization programmed in new areas, but the loss of this buyer meant MF had inadequate seed and could not supply many newly-mobilized farmers.

Both MF and FAIDA learned many lessons during this period and despite their past problems they resumed collaborating in 2006.

8.3. Monitoring

The crop calendar facilitated the monitoring of the company's commitment to the work plans and FAIDA also conducted regular field visits and received periodic reports from MF. Nearly all field activities were undertaken jointly by MF and FAIDA field staff so they were fully aware of each other's contributions. In addition, the MF and FAIDA field supervisors submitted reports on their field activities. If FAIDA field agents felt that MF was not performing as agreed, they communicated their concerns to their manager who would contact the MF manager responsible for the outgrowing activities and request improvements. Sometimes, however, FAIDA felt that it did not have adequate leverage to ensure that the company would make all necessary and agreed-upon investments. FAIDA felt that the company understood (from the crop calendar) the timing of different activities, but it also felt that they did not fully recognize the time needed to oversee and supervise the scheme, particularly at the head office level.

8.4. Capacity Building Activities

FAIDA and MF field staffs worked closely together in the field and there was a lot of exchange and mutual learning which contributed to building MF's capacity. The FAIDA agronomist imparted significant knowledge to MF's field officers, greatly facilitating their capacity-building. Most MF FOs were trained farm workers who had ample experience in flower seed production and extension, but little advanced knowledge of soil fertility, crop diseases, etc. FAIDA also supported MF by introducing yield and quality improvement programs such as advising the company to concentrate a limited number of similar varieties per location so that only a few sieves would be required for cleaning seed since different varieties require different sieves, which can be expensive for farmers.

Specific activities FAIDA undertook in supporting MF expand its outgrowing operations included assisting with:

1. Selecting locations and selecting and mobilizing farmers
2. Designing and/or commenting on outgrower contracts that buyers developed and translating them into the local language, sometimes for a fee
3. Facilitating meetings between the company and farmers to discuss the business, negotiate contract terms and end of season / contract evaluations
4. Organizing and facilitating platforms in which all stakeholders in the value chain could discuss the business venture and make commitments to start contract farming arrangements / outgrower schemes
5. Organizing farmer exchange / learning visits and farmer field days
6. Preparing technical / extension brochures and pamphlets on crop and/or translating them into the local language
7. Conducting follow-up visits and advising farmers, i.e. field extension services
8. Organizing collection centers at the farm level and identifying lead farmers to interface between the company and farmers
9. Mediating conflicts between the company and farmers
10. Developing policies / procedures relevant to the outgrowing operations.

THE FIELD SUPPORT PROGRAM

LEARNING ON OUTGROWING INITIATIVE

A CASE STUDY
ON
ITC'S CHOUPAL FRESH VEGETABLES
OUTGROWER PROGRAM
INDIA

Presented by:
Vikas Choudhary
Consultant

Action for Enterprise
November 2008

Table of Contents

Abbreviations

APMC	Agriculture Produce Marketing Committee
GMED	Growth Oriented Micro-Enterprise Development
ITC-IBD	ITC-International Business Division
SKU	Stock Keeping Units
USAID	United States Agency for International Development

1. Introduction

The rapid development of the organized food retail sector (modern supermarkets, hypermarkets and specialty stores) is a significant indicator of the economic and cultural revolution that India is undergoing. According to the findings of a recent joint study conducted by the Federation of Indian Chambers of Commerce and Industry and Ernst and Young, organized retail sales will rise from the current five percent of total retail sales to thirty percent over the next ten years. Another study by Deloitte, Haskins and Sells indicated that organized food retail grew at an unprecedented rate in 2007, accounting for eight percent of total retail sales compared with five percent in 2006. The burgeoning consumer preference for supermarkets has its roots in the rise of the urban middle class. Most major corporate houses, multinational companies and Indian retail companies are actively engaged in the sector and competing for a larger slice of the pie and this growth in organized food retail provides significant opportunities, and challenges, for small-scale Indian farmers who may become preferred suppliers – or be marginalized – by this emerging food value chain.

This case study describes the experiences of one food retailer, ITC, in expanding its outgrowing activities to the fresh vegetable sector. The study describes ITC and its incentives for outgrowing and presents the structure of its outgrowing operation and its successes and challenges. Finally, it describes the role that GMED, a development organization, played in facilitating the expansion of ITC's outgrowing operations.

2. ITC: The Lead Firm

ITC, one of India's largest corporations, has diversified business interests in the cigarette, tobacco, pulp and paper, hotels, IT, retail and agribusiness sectors. According to ITC's 2008 annual report, its gross turnover was 213.55 billion rupees (US$4.8 billion) and its net profit after tax was 31.20 billion rupees (US$.71 billion). ITC-International Business Division (IBD), one of the largest commodity traders, has set up an e-Choupal system[8] for directly procuring soybean, coffee, wheat, rice, grains, pulses, shrimp and other seafood directly from farmers.

Choupal Fresh is a new ITC-IBD horticulture retail venture, originally conceptualized as cash and carry stores that would wholesale fresh produce primarily to pushcart vendors, but also to various retailers and institutional buyers. The venture began with three pilot outlets in Chandigarh, Hyderabad and Pune. Though individual consumers flocked to the stores when they opened, there was an almost complete lack of acceptance by pushcart vendors. Since sales to consumers earned high margins, the outlets changed focus to concentrate primarily on retail sales, though some wholesaling continued. In addition to the Choupal Fresh outlets, ITC has entered into agreements with several other retailers to manage the fresh produce category in their stores under shop-in-shop arrangements. Besides these two arrangements, ITC has developed

[8] ITC has initiated an e-Choupal activity that places computers with Internet access in rural farming villages to serve as both a social gathering place for exchanging information (choupal means gathering place in Hindi) and an e-commerce hub. What began as an effort to re-engineer the procurement process for soy, tobacco, wheat, shrimp and other cropping systems in rural India has created a highly profitable distribution and product design channel for the company—an e-commerce platform that is low-cost fulfillment system focused on the needs of rural India. (http://www.digitaldividend.org/case/case_echoupal.htm)

linkages with several institutional buyers (hotels, caterers, hospitals etc.) that regularly buy in bulk.

Fresh produce is a *destination category*, meaning it attracts customers to the retail store. While many grocery items are purchased only once in a fortnight or month, fresh produce is purchased every second or third day. Though fresh produce attracts consumers to stores, it can be a *loss leader*[9] that needs to be sustained and subsidized by sales of other products. Many emerging retail players initially focused only on retailing fresh produce, but soon realized that fresh produce alone might be insufficient to meet bottom-line targets—they needed to diversify their product offerings to meet consumer needs. As an example, Reliance Fresh, another major Indian retail operator, started with 100 percent fresh produce but has reduced that to 40-50 percent of their SKU (Stock Keeping Units) with the other 50-60 percent comprising other groceries. ITC has now moved in that direction and begun selling other groceries in addition to fresh produce.

ITC Fresh Produce Venture: A brief overview

Location	Choupal Fresh	Store-in-Store Arrangements	Collection Center	No. of Farmers
Hyderabad	6	10	2	125
Pune	2	4	3	315
Chandigarh	2	1	2	310

(Source: Interview with ITC staff, July 2008)

3. Incentives for Outgrowing

India currently is going through a retail revolution with multiple competing players vying for consumer attention. ITC decided to differentiate itself from its competitors on the basis of its produce price and quality. ITC felt that a well-integrated and efficient supply chain with greater control over production processes was a prerequisite for delivering quality produce to its consumers. Furthermore, ITC has a corporate philosophy of *creating enduring value* for all stakeholders in the supply chain, from producers to consumers. ITC was one of the first Indian companies to enter into a large-scale, direct procurement arrangement with farmers through its e-choupal platform[10], which allows it to reach more than four million farmers in over 40,000 villages who grow soybean, coffee, wheat, rice, pulses and shrimp through nearly 6500 kiosks across ten states in India[i].

All these factors prompted ITC to enter into a direct relationship with vegetable farmers; however, it had no prior experience procuring from horticulture farmers, who often have different attributes than grains / commodity farmers. ITC felt that horticulture farmers were more commercially-oriented, closer to the market and would respond more favorably to market demands and trends than grain / commodity farmers. Furthermore, fresh produce market

[9] A loss-leader is a commodity that retail stores offer at or below cost to attract customers. This is a retail concept that sets prices on certain items at a loss and then widely advertises them to draw trade into the store. The loss is considered a cost of promotion that is offset by profits on other items sold.

[10] Through its e-choupal platform, ITC places computers in villages where farmers receive information on crop prices that ITC is willing to pay. Based on this information, farmers transport their produce to ITC procurement sites where ITC purchases it in a transparent fashion and at a favorable price.

dynamics and farm-level production dynamics are very different from those of grains / commodities, requiring a more intensive, interactive system of outgrowing in which farmers are much more integrated with ITC than those producing grains / commodities.

4. Structure of Outgrowing Operations

Unlike some of its competitors, ITC is a conservative company that takes a pragmatic and calculated risk approach to new ventures. Its 2008 annual report mentions the piloting of Choupal Fresh stores, stating that "the business intends to further strengthen its farmer linkages and its expertise in the management of perishables before scaling up the business". Unlike competitors who embarked on a strategy of rapid and massive scale-up of their retail operations, ITC's strategy relied on modeling, testing, learning, improving, and consolidating its business model in a few locations before expanding operations. ITC believes that a large-scale roll out should happen only after the business model has been perfected. In keeping with this methodical approach, ITC's fresh vegetable outgrowing operations have evolved during the three years since inception.

This paper outlines current ITC fresh vegetable outgrowing operations without analyzing its evolution. ITC tried multiple formats for procurement and sales since 2006 before arriving at the present configuration. In 2005, ITC signed an MOU with USAID's Growth Oriented Micro-Enterprise Development (GMED) project to help set up and support ITC's outgrowing operations. Since then, GMED has been advising ITC and building the technical and management capacity of its staff to better integrate smallholder farmers into their operations (see section 7). The present model is still a work in progress and ITC is incorporating what it is learning into the model to make it more robust. ITC believes in decentralized operations and giving operational freedom to regional managers. Though this has led to slight variations in its outgrowing operations in the three different locations, the overarching outgrowing structure is basically the same.

4.1. Organization

Before establishing its outgrowing operations, ITC contracted with institutional suppliers to supply fresh and exotic fruits, onions, potatoes and a variety of vegetables to its Choupal Fresh stores. The seasonal nature of operations and relative geographical concentration of production in a few locations led to the outsourcing of fresh produce. For the bulk of vegetables it procured, ITC entered into direct relationships with vegetables growers in certain clusters[11] close to its retail centers. For now, ITC's outgrowing operation is restricted to fresh vegetables and it procures only 10 percent of the total vegetable production of its farmers. Farmers sell the remaining 90 percent of their produce to alternate markets. ITC expects procurement volumes to pick up gradually following expansion of its retail operations and hopes that in future they will be able to purchase the bulk of the outgrowers' production. Currently, ITC's purchase of fresh produce is 2.5-3 tons per day per store on weekdays and 3.3-3.5 tons on weekends; fresh vegetables account for 1-1.5 tons. ITC's outgrowing structure consists of a village collection

[11] For the purposes of this paper "clusters" refers to the geographic areas where ITC is carrying out vegetable outgrowing operations with farmers.

center, ITC field extension staff, lead farmers and small vegetable farmers. Appendix 1 presents a diagram of ITC's outgrowing structure; each unit of the structure is described in detail below.

Collection centers: ITC currently operates two collection centers in Hyderabad, three in Pune and two in Chandigarh, all of them located within a 60-120 km radius of its retail outlets. ITC currently procures 30-35 types of vegetables daily from these collection centers. Farmers in roughly 20-25 villages within a 30 km radius supply fresh vegetables regularly to the centers, which accept fresh vegetables from 9 am to 4 pm. Most farmers bring their produce to the collection centers in small vehicles or tractors. ITC supplies crates to some of their trusted and regular farmers, while others bring vegetables in gunny bags or their own packaging material. ITC's collection center staff grades and sorts the produce on the spot and procures only Grade A vegetables from the farmers. ITC is working with farmers to help them see and understand the differences between Grades A and B and ensure they bring only Grade A produce to the centers.

According to ITC management, this transparent, on-the-spot grading system is very empowering for the farmers. Since ITC buys only Grade A produce, it saves time and money in grading and sorting operations at the retail end and enables the firm to deliver only the best and freshest produce to consumers. On the other hand, after seeing this grading a few times farmers are cued into the ITC system and have the incentive to produce and bring only their best quality produce to the collection centers, which can make grading and sorting redundant.

ITC extension staff: ITC has created a cadre of staff to provide extension services to farmers to ensure a consistent supply of quality fresh vegetables. Each collection center has an agriculture extension officer supported by two extension agents. The extension officer is usually a professional agriculture graduate with extensive training and experience in delivering agronomic advice to farmers. Extension agents are young, educated members of local farming families who have several years farming experience. ITC recruits and trains these young people in extension methodologies.

Lead farmers: ITC enrolls lead farmers in all its clusters. These progressive farmers are early adopters of new technologies and production techniques who significantly influence other farmers. Lead farmers reduce transaction costs for ITC while allowing it to control production and improve product quality and supply chain efficiency. Each lead farmer supervises the production of 15-20 farmers and provides them with technical and other information and knowledge. ITC envisages that, in future, lead farmers will be the firm's main coordinators for scheduling outgrower production.

Farmers: Currently, more than 740 farmers supply fresh vegetables to ITC in its three different locations. The majority of these farmers are smallholders with less than two acres of land who have been engaged in vegetable farming for a number of years.

4.2. Technical assistance

ITC has initiated and successfully implemented many activities to improve the quality and quantity of the fresh vegetables produced by its outgrowing operations farmers. Some major activities are described below:

ITC demonstration plot: ITC has set up demonstration plots on lead farmer's land in the Pune and Chandigarh clusters to showcase the efficacy of different agronomic practices. ITC extension agents train and supervise lead farmers in creating and managing the plots and farmers visit them to learn about and adopt practices the lead farmers are using. In Hyderabad, ITC leased some land in the villages and set up company-owned and managed demonstration plots. Many farmers come to these demonstration plots to see the effect of different practices and ITC plans to organize field days to systematize the learning process.

Seedling transplantation: The majority of vegetable farmers in India are accustomed to using seeds for vegetable production. However, ITC suggests that setting up seedling nurseries and performing seedling transplantation, instead of direct sowing of seeds, is a good agriculture practice. A few initially skeptical farmers began adopting the practice and soon most farmers in the villages, including those who were not part of the ITC outgrowing arrangement, accepted the seedling transplantation practice. In a few villages, this practice is now the norm and entrepreneurial farmers who switched from vegetable production to seedling production in nurseries now sell the vegetable seedlings to other farmers. While farmers in the Hyderabad clusters were slow to adopt this practice, farmers in Pune and Chandigarh clusters picked up on it much more quickly.

Input supplier linkages: The availability of good quality inputs has long been a major constraint for many farmers. ITC developed links to companies such as Syngenta, Bayer, and others to ensure a consistent supply of good quality inputs to ITC clusters. In some cases, ITC procured inputs from the companies and supplied them to the farmers directly while in others, the suppliers used lead farmers as the distribution channel to sell inputs to individual farmers. In the Pune cluster, ITC leveraged Syngenta's existing input center to ensure supply of good quality seeds to its farmers. Bayer currently provides plant protection assistance and is testing new products in the Hyderabad cluster demonstration plots. A few local suppliers are also selling organic enhancements directly to lead farmers in the villages.

Improved agronomic practices: ITC has introduced many new agronomic practices to participating farmers, including soil and water testing, installation of tray nurseries, shade netting for appropriate crops, raised beds with plastic mulching, staking of vine plants, use of implements to ensure uniform planting depths, spacing, proper field preparation and similar measures. The introduction of drip irrigation and *fertigation* – applying fertilizers through an irrigation system – proved to be very important under Indian cropping conditions. ITC farmers have adopted many of these practices, resulting in higher production and better quality produce.

- **New Varietals Introduction:** Farmers in the production clusters have adopted more than 30 new varieties of vegetables and ITC introduced certain exotic vegetables in a few lead farmer plots.
- **On-farm Extension Services:** ITC provides regular on-farm extension services to participating farmers and its extension officers and agents periodically visit and monitor production and provide farmers information on general and specific issues. Farmers' input costs and production losses due to pest and disease have decreased considerably due to the timely availability of expert advice from ITC extension services.

There are some variations between the three clusters with which ITC works. Farmer adoption of new agronomic practices is quite low in Hyderabad clusters, while those in Pune and Chandigarh clusters have adopted, replicated and scaled-up several new agronomic practices.

4.3. Contracting and pricing strategies

Contractual arrangements: ITC-IBD's Chief Executive Officer Mr. Shivakumar once remarked that, "We are more into *contact farming* and not *contract farming*...We handle the whole exercise very differently. We are in constant touch with the farmers who sell us produce."[ii] ITC did not enter into a formal legal contract with any of its outgrowers. Instead, ITC enrolled a group of farmers in each cluster who voluntary agreed to abide by the terms and conditions of the informal arrangement between them and ITC. The informal contract was verbal and based on trust and a proposed long-term, mutually beneficial relationship. When it enrolls farmers, ITC explains that it provides extension services, seedlings and crates to farmers. ITC promises to procure Grade A vegetables from farmers and, in turn, it expects farmers to grow them according to plan and sell their produce to ITC. Conflicts are resolved by dialogue and discussions.

Pricing: Instead of a fixed, pre-determined price, ITC follows a *dynamic market reference* pricing policy. ITC staff compiles the prices of reference mandis[12] every evening and offers the same prices to the farmers at its collection centers the next morning. This means that farmers can get mandi prices at a collection center near their village. Though ITC deducts packaging and transportation costs (10 percent), which farmers would incur if they sold directly in the mandis, they do not have to pay mandi tax or loading and unloading charges and it saves them time. Farmer's net earnings increase four to eight percent when they sell directly to ITC at collection centers.

4.4. Incentives for farmers

Increased productivity, lower cost, improved technology and on-farm advice and support are some of the biggest incentives for farmers to work with ITC outgrowing operations. During ITC pilot operations, farmers experienced reduced production costs averaging 16-18 percent, significant quality improvements, productivity gains and net income increases averaging more than 30 percent[iii].

5. Fundamentals of Success

ITC feels it is still in the learning phase and its outgrowing model is far from perfect. Though it has yet to claim outgrowing operations a success, ITC thinks a few key issues have contributed to its accomplishments thus far.

1. **Demand Pull:** Demand pull, i.e. when demand exceeds supply on the retail end of the operation, it is a significant driver of successful outgrowing operations. Initially, demand was lower than ITC expected it to be and it could not purchase the volume of produce that farmers expected to sell, and this led to frustration and disillusionment. However,

[12] Mandis are the government mandated auction houses where Indian farmers sell much of their agricultural production.

when retail operations picked up and demand for its fresh produce increased, ITC was able to procure more vegetables and re-establish its relationship with its outgrowers.

2. **Clear communication: D**uring the initial phase of the operation, there were cases when lines of communication between ITC and its outgrowers were not very clear and led to a breakdown of trust. Once it realized the reason for this, ITC directed extension agents to communicate frequently and clearly with farmers and provide them information on major decisions, procurement plans and demand schedules. This led to increased trust and stronger relationships between the outgrowers and the company.

3. **Seeing is believing:** Demonstration plots have been one of the most successful strategies for changing farmers' agronomic practices. Farmers who were very reluctant to change the way they did things adopted new practices after seeing the demonstration plot results. The plots also strengthened trust and relationships between the company and outgrowers.

6. Major Challenges

ITC has faced numerous constraints and challenges in its outgrowing operations; those that have yet to be fully resolved could present serious bottlenecks to operational growth.

1. **High attrition rate of field staff:** Finding and maintaining skilled and experienced human resources is one of ITC's greatest challenges. Trained agribusiness professionals are in short supply and in great demand in India, leading to a high level of attrition and frequent staff turnover. Since 2006, ITC has recruited many field managers and extension officers and agents, but the retention rate is low and few people stay more than a few months. Maintaining good relationships between the company and farmers is critical in contract farming and frequent turnover of field staff breeds discontent and decreases the level of trust in the firm. Every new field person has to start afresh and build relationships with lead farmers and farmers. By the time they and farmers become comfortable with one another, they move on to new jobs. This lack of field staff continuity is a matter of concern for ITC though it has not yet impacted the overall operations and ITC feels the matter is under control.

2. **Uncertain enabling environment:** When deciding on the location of its retail and procurement clusters, ITC was very cautious and selected only areas where the state government had amended the Agriculture Produce Marketing Committee Act (APMC)[13] to enable direct procurement from the farmers. ITC invested almost two years in working with the Malerkotala cluster in Punjab for its Chandigarh operations. The farmers were very responsive and able to produce to ITC specification and the relationship between ITC and farmers was positive. However, ITC realized that Chandigarh, the capital of

[13] Under the Agricultural Produce Marketing Committee Act (APMC), farmers were required to sell their products exclusively through government-mandated auction markets, known as *mandis*. Commission agents and brokers handle all *mandi* purchases, often in a collusive fashion. The central government has issued revision to the APMC, providing farmers with alternatives to the *mandi* by allowing them to sell their produce to other buyers, including entering into contract growing arrangements. Agriculture is, however, a state subject in India, meaning that each state much enact its own version of the APMC revision. This is happening, slowly.

Punjab, had its own rules and regulations regarding vegetable procurement when municipal authorities informed it that procuring from Malerkotala cluster farmers violated municipal rules, which do not permit retailers in the city to procure directly from farmers in villages. The authorities directed ITC to procure its vegetables from suppliers in Chandigarh municipality only. This put ITC in a difficult position and to comply with the regulation, it had to shift from Malerkotala – causing heavy losses and the disruption of its relationships with farmers. Uncertainty in the enabling environment puts ITC investments at risk and challenges its ability to continue and expand operations.

3. **Profitability of Retail Operations:** ITC and other major vegetable retailers are still struggling to make their operations profitable. Many companies are incurring heavy losses despite having made large investments and they are struggling to streamline their operations to contain losses. For this reason, ITC has been unable to increase procurement from farmers and expand operations. Management hopes that operations become profitable soon so they can expand.

4. **Side-selling:** ITC procurement volumes are relatively low so side-selling is not an issue and since ITC buys only Grade A vegetables, farmers have surplus produce to sell elsewhere. In fact, ITC farmers sell their surplus to some major ITC competitors. As ITC and other companies increase procurement volumes, ITC management thinks farmer loyalty and side-selling could become an issue.

7. Role of Development Organizations—the ITC Perspective

ITC partnered with the USAID GMED project in 2005 to develop a program for integrating farmers into the ITC Fresh produce supply chain. Fresh produce retail is a relatively new sector in India and there hasn't been much experience integrating farmers into modern retail chains. ITC was looking for a partner who could fill that knowledge gap and the GMED project proposed itself as that partner. ITC signed an initial, 18-month MOU with GMED for the project to assist ITC develop a *Good Agricultural Practices* protocol and train ITC staff to deliver extension services to farmers. GMED helped ITC develop strategies for integrating farmers into its supply chain, designed the demonstration plot interventions, linked ITC to input and equipment suppliers (seed, pest control, drip irrigation, shade nets etc), and proposed the lead farmer–outgrower model.

In 2007, GMED and ITC signed a new MOU focused primarily on training ITC staff to deliver extension services to farmers. ITC employed several educated young farmers as extension agents and GMED provided six months of training for 13 agents—6 in Hyderabad, 4 in Chandigarh and 3 in Pune—in agronomic, post-harvest and farm management practices. GMED's internal staff and external consultants conducted these on-site trainings. Though most of the training was field-based and hands-on, it also included theory and in-class components. The first training lasted ten days and the rest were intermittent and 1-2 days duration. ITC management appreciated this assistance and considered GMED a catalyst that was able to bring in international experience and expertise. The international learning and incorporation of good agricultural practices has been a great help for ITC.

8. Role of the Development Organization—the GMED Perspective

The GMED India program is sponsored by USAID and administered by ACDI/VOCA and its goal is to develop commercially viable, sustainable and scalable approaches to fostering the growth of micro and small enterprises. The project focuses on linking smallholder vegetable and fruit farmers with high-value, well-organized wholesale and retail processing and export markets and helping to build the capacity of farmers to meet the requirements of those markets.

8.1. Company Selection

2004-2006 were quite significant for the Indian retail sector as many major corporate groups entered into the organized food retail sector. Taking a lead firm approach, GMED decided to partner with selected retail players. GMED used several criteria to select the lead firms it would work with:

- Business model
- Scale potential
- Transparency
- Ability to respond to market demands
- Long-term strategy

The initial GMED strategy was to work with a few lead firms, but later it decided to work exclusively with ITC. Supply chain development was an important ITC strategic element and it wanted an exclusive arrangement with GMED. Since ITC did not want GMED to work directly with its competitors. GMED agreed to provide assistance only to ITC for a period of 18 months. The firm and the project agreed that after that time, GMED could partner with other retail players and share its knowledge and experience with the sector as a whole.

8.2. Establishing credibility

It took almost six months from their first meeting for ITC and GMED to sign an MOU. Part of the delay concerned operational issues, but the main reason was the time it took for the two parties to trust one another enough to become partners. GMED was unknown in India and partnering with it and following its advice on how to develop a supply chain strategy could have put ITC at great risk. The GMED team met regularly with ITC during those six months and slowly proved itself; its Chief of Party was a strong manager with over 30 years experience in 25 countries—this piqued ITC's interest. GMED also brought international consultants and expert professionals from its headquarters office during the initial meetings with ITC, which also helped build ITC's confidence in GMED's technical competence and its ability to deliver. Fresh produce procurement from farmers was a relatively new concept in India and ITC appreciated that the GMED team had had done similar work in other countries. Gradually ITC's trust level and confidence in GMED's ability grew and they entered into a formal partnership.

GMED was a purely advisory project without grants or loans that provided technical support, including:

- Advising ITC on the design of its outgrowing operations
- Development of criteria for village, lead farmer and farmer selection

- Technical support through international consultants who worked with the ITC team in each of the three clusters
- Development of agronomic practices and a package of practices for dissemination to farmers
- Training of ITC extension agents in delivering agriculture extension services to farmers.

GMED held strongly to the principle that this was ITC's outgrower program and that its primary task was to assist ITC design and implement it. ITC's extension staff served as the real point of interaction with the farmers – the GMED team and its consultants mostly worked behind the scenes and rarely interacted directly with the farmers.

8.3. Cost-share agreements

GMED paid the consultants' fees and their associated costs and ITC paid for the hardware, field-level investments and all field staff costs. This arrangement ensured that ITC was taking responsibility for the outgrowing operations, bearing the majority of costs and making the requisite investments. GMED decided early on that it would focus only on building the technical capacity of the lead firms it supported to ensure partners would not come to depend on GMED. Because it acted as a facilitator and advised clients such as ITC how to set up systems, once those systems were established, they took responsibility for new operations and scaled up on its own.

8.4. Managing collaboration

The GMED project never interacted directly with producers, only with ITC field staff who worked with farmers on a daily basis. GMED assisted ITC not only to change farmer practices and perceptions, but also to change its own corporate culture, management practices and priorities. GMED worked with ITC at three levels:

1. **Strategic—top management:** The project manager and consultants frequently worked with top ITC management, advising and apprising them on outgrower program progress and the procurement strategy and helping them design partnership strategies with other organizations.
2. **Operational—clusters:** GMED staff interacted regularly with the ITC staff, advising them on planning weekly operations and outgrower programs.
3. **Field—extension staff:** The team worked primarily with ITC extension staff, using formal and hands-on informal training to build both their capacity to deliver extension services effectively and their technical competency / agronomic knowledge of different crops and agriculture practices.

In playing a catalytic, facilitative role, GMED ensured that ITC did not come to depend on it to manage their operations. Once ITC field extension capacity was strengthened and a package of practices developed, GMED reduced its role and frequency of interaction with the ITC team and ensured the continuity and sustainability of ITC's outgrowing operations over the short and long term.

Relationship and trust building is a long-term, gradual process and very small mistakes can break relationships that take years to build. ITC built farmers' trust in it through weekly extension staff visits and the results achieved on lead farmer demonstration plots. At the same time, when ITC delayed procuring their vegetables, their trust in the company weakened although eventually it was restored when retail sales picked up and ITC stepped up its procurement. GMED's trust level with ITC was built gradually and increased as ITC began to see the results of its advice in terms of higher quality and quantity of produce from outgrower farms.

8.5. Monitoring

This was a commercial venture for ITC and it was committed to making the requisite investments to ensure commercial success. However, the outgrowing operations supplied only part of the produce it needed for its Choupal Fresh retail operations. It faced challenges to ensuring the agreed-upon investment in the outgrower programs, especially in view of the frequent turnover of its field-level staff and administrative mechanisms. Sustaining its committed investment became even more difficult for ITC when it went through a cost-cutting exercise to reduce losses incurred in its retail venture. Once its retail sales picked up, however, ITC renewed its committed investment to the outgrowing operations.

GMED met regularly with top ITC management to ensure that work was progressing as planned. These meetings also served a monitoring purpose and GMED consultants and staff visited the field with ITC staff periodically and established a feedback mechanism to monitor program progress. The GMED team felt it would take a year or two (or three to four cropping seasons) before the company developed systems and practices that could ensure a successful and sustainable outgrowing operation. GMED also felt that technical support from a development organization could be useful and necessary during that time.

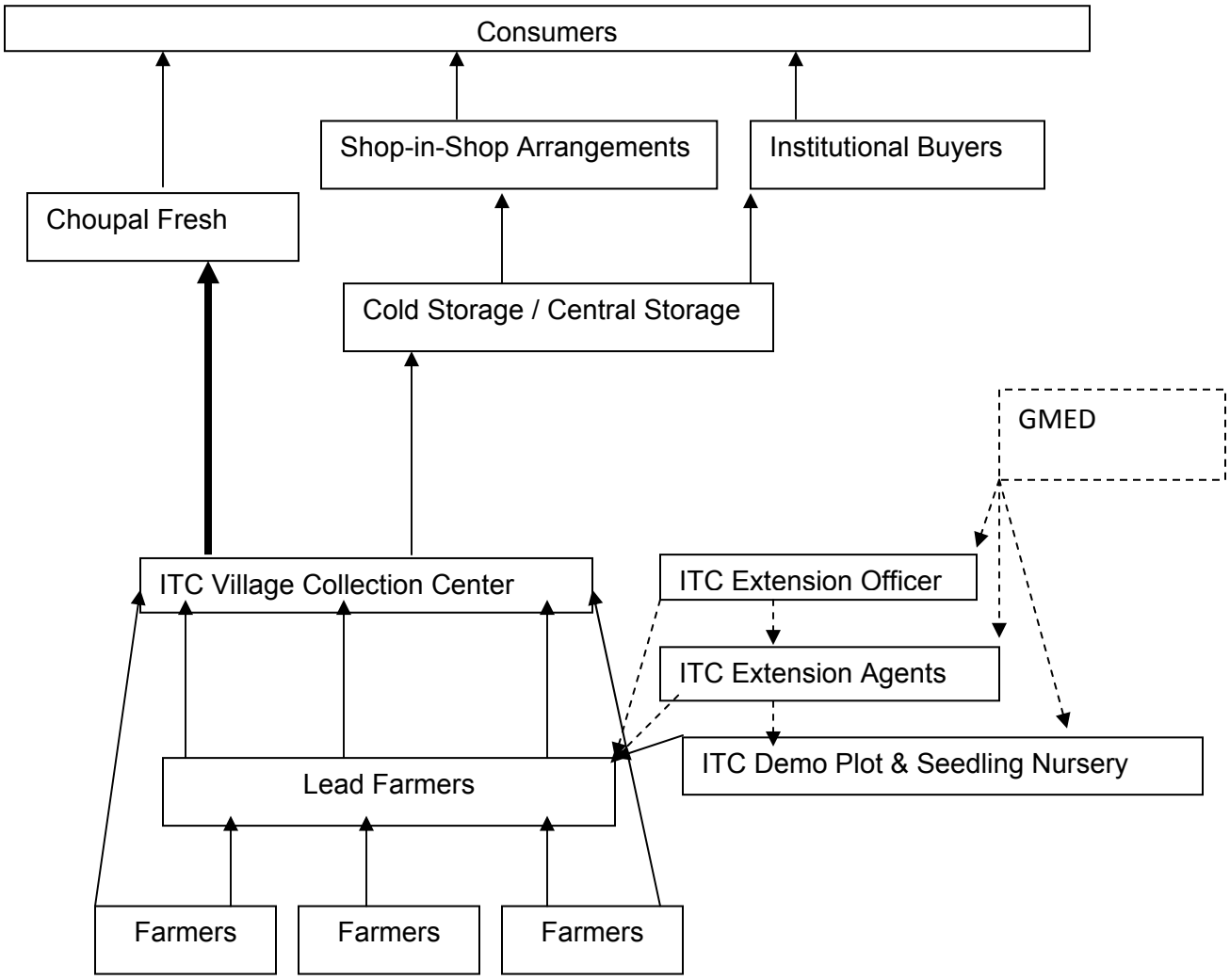
8.6. Capacity-Building Activities

GMED conducted numerous capacity-building activities for ITC field staff, who then provided farmers with training and extension activities. These had very positive impact.

- ***Farmer training and extension activities***: The bulk of GMED's focus was on training ITC extension staff to develop a package of practices and provide extension services to lead farmers and outgrowers. This proved very successful; farmers accepted the advice extension agents provided, improved their productivity and reduced their losses.
- ***Demonstration plots:*** The success of demonstration plots played a crucial role in building farmers' trust and confidence and in facilitating their adoption of specific agronomic practices such as the use of mulch, adequate spacing and seedling transplantation. GMED advised ITC that demonstration plots should be one of the first entry-level activities in selected villages and in some, even farmers who were not a part of the outgrower program adopted the improved practices, thus broadening the development impact.
- ***Promoting linkages with input suppliers:*** During the initial phase of the project, GMED helped ITC establish linkages with Syngenta, a major seed supplier; pesticide dealers; and shade net and drip irrigation providers so it could better support its outgrowers.
- ***Promoting improved organization / management systems:*** The GMED team worked with ITC to design procurement, farmer interaction and field management systems.

The GMED team felt that the ITC outgrowing operations yielded significant dividends, both for the company and its outgrowers, and that ITC, with support from GMED, was able to create a model of integrating smallholder farmers into its corporate supply chain. Although ITC's scale-up and replication didn't happen exactly as planned due to the slowdown of its expansion, the lessons learned during the initial stages lead the team to hope that rapid scale up will happen soon. The GMED staff also is hopeful that other firms such as Reliance and Bharati learn from the ITC experience and adopt similar models and incorporate large numbers of smallholder farmers into organized fresh produce supply chains.

Appendix C-1: ITC Out-grower Model Structure



End Notes

[i] ITC's website : http://www.itcportal.com/sets/echoupal_frameset.htm

[ii] The Economic Times, ITC Plans expansion of Choupal Fresh in the state, 17th January 2007, Mumbai

[iii] Singh Deo Datt and Don Taylor 2008, *Incorporating smallholder fruit and vegetable farmers into organized retail value chains*, Presentation

FCCI and Ernst and Young 2007. *Winning with Intelligent Supply Chains*, Federation of Chambers of Commerce of India

ITC 2008 . ITC Annual Report 2008, ITC Calcutta

THE FIELD SUPPORT PROGRAM

LEARNING ON OUTGROWING INITIATIVE

A CASE STUDY
ON
EAST AFRICA GROWERS
VEGETABLE EXPORTS FROM KENYA

Presented by:
Eric Derks

Action for Enterprise
November 2008

Table of Contents

Abbreviations

AM	Area Managers
EAGA	East African Growers Group
GOK	Government of Kenya
Ha	Hectares
MRL	Maximum residue levels
MT	Metric ton
SHG	Self Help Groups
TA	Technical Assistants
United Kingdom	UK

1. Introduction

The following describes the East African Growers Group (EAGA) and its outgrowing operations. This case-study looks first at the overall market and operations of EAGA and discusses the company's incentives for undertaking outgrowing activities. The case then presents the functioning and dynamics of its outgrowing activities before concluding with a discussion of reasons for EAGA's success and its biggest remaining challenges.

2. Description of East African Growers Group (EAGA)

EAGA began exporting fresh vegetables to Europe 20 years ago, taking advantage of opportunities to supply importers with fresh produce outside of Europe's main growing season. Today, EAGA is the largest fresh vegetable exporter in Kenya, exporting roughly 250 metric tons (MT) per week in the high season and close to 100 MT per week in the low season.[14] In addition to vegetables, but not part of this case-study, EAGA also exports fresh tree-crops such as avocados and passion fruit.

The vegetables EAGA exports include French beans, fine beans, broccoli, snow peas, sugar snaps, carrots and baby corn. Outgrowers who currently supply 60% of its exports primarily grow fine beans, snow peas and sugar snaps. The company's own farms supply the remaining crops and volumes.

Close to 90% of exports are sold to European supermarkets, most of them located in the United Kingdom (UK), including Tesco and Marks & Spencer. Of the remainder, most are sold to European wholesalers with smaller amounts going to Gulf-state importers. To satisfy its main UK customers, EAGA must assure compliance with GlobalGap standards and the additional requirements of UK supermarkets, including standards for product traceability, maximum residue levels (MRL) of agro-chemicals, packaging and product size and shape. In addition, EAGA's customers also insist that producers adhere to specific safety procedures for handling agro-chemicals, comprehensive record keeping, risk management procedures, and Fair Trade practices[15].

EAGA's operations consist of the following:

- Management offices in Nairobi
- Nairobi pack-house for receiving, cooling, grading and packing fresh produce (1000 employees)
- Seven farms with a total of 500 hectares (Ha) of arable land (2000 employees)
- 77 outgrowers (approximately 50 are part of four *self-help* groups).

[14] In the low season (July to September) demand drops as European markets purchase more from local sources
[15] The required Fair Trade practices are articulated mainly by customers and include such aspects as on-farm sanitation structures and farmer development committees.

3. Incentives for Outgrowing

A fundamental determination for EAGA is whether to assure production levels through its own farms or through outgrowers. Some crops must be grown on its own farms because the high production costs or small quantities needed are not profitable for outgrowers.

At present EAGA purchases 60% of its exports through outgrowers. Despite the risk of side-selling[16], outgrowers pose lower production risks and provide the company with greater flexibility in planning. These benefits are seen in the following examples:

- As market demand drops in the low season, EAGA can schedule outgrowers to produce less without reducing the productive capacity of its own farms and the labor required to operate them.

- As levels of demand in importing markets fluctuate on a weekly and even daily basis, EAGA does not have to bear the entire brunt of sudden drops in demand, but can share this burden with outgrowers. EAGA is aware, however, that sharing this burden can be a source of ill-will with outgrowers and one reason for side-selling or switching to a different buyer.

- Given the relative scarcity of suitable plots of land for large-scale commercial farms, using outgrowers allows EAGA access to areas of the country with diverse climatic conditions. As such, the company can offset the seasonal limitations of one area with a shift to production in another, thereby smoothing out overall production levels and assuring the availability of the vegetables it needs. Having outgrowers in different areas also mitigates the effects of droughts that tend to affect one part of the country more than another.

- EAGA agronomists have noted annual declines in water levels in many parts of the country, which the company can manage by strategically selecting outgrowers with more reliable and plentiful water sources.

- Diversified production areas can be achieved through contracting with outgrowers in different areas, which mitigates the risk and spread of diseases and infestations to which a large farm is more prone.

In addition, working with outgrowers (particularly small-scale farmers) improves EAGA's standing with European buyers who value vegetables that are considered Fair Trade. The UK supermarkets in particular place a premium on Fair Trade produce.[17]

[16] Refers to a farmer who sells vegetables produced under contract with EAGA to another company or buyer
[17] Anecdotally, one UK supermarket values Fair Trade vegetables so much that it requested a competitor to EAGA to only supply it with Fair Trade produce, somewhat missing the spirit of the movement.

4. Structure of Outgrowing Operations

4.1. Organization

This section first looks at the operational structure of EAGA's outgrowing operations and then examines the two types of outgrowers the company engages.

East African Growers

EAGA coordinates the overall outgrower activities from its pack-house offices near the Nairobi airport. The operational divisions and their responsibilities with regard to outgrowers include the following:

- ***Logistics Division***: scheduling transportation of seeds and collection of harvested vegetables
- ***Planning Division***: overseeing planting schedules in accordance with orders and anticipated demand, supporting Technical Assistants (TA) and Area Managers (AM), negotiating and signing contracts with outgrowers
- ***Monitoring Division***: assuring compliance with GlobalGap standards and those for major supermarkets such as Tesco in the UK.

EAGA is active in two regions, Mount Kenya and Central, the latter is the area around Nairobi.[18] Each region has one Regional Manager (RM) and two AMs. The total number of TAs is 15, which is approximately one TA for every eight to ten farmers. The primary responsibilities of EAGA field staff are listed in Table 1.

Table 1: EAGA field staff and their responsibilities

Staff	Primary responsibilities
Regional Managers n = 2	• material and technical support to AMs and TAs • communication with Nairobi and execution of planning directives for region • organization of training and other events with outgrowers
Area Managers n = 4	• technical support to TAs with weekly visits • execution of area planning activities and planting schedules • report on harvest estimates and timing • recruitment, assessment and contracting of new outgrowers • monitoring of outgrower progress toward compliance with standards
Technical Assistants n = 15	• technical support to outgrowers • monitoring record keeping of all outgrowers' activities • monitoring and control of pests and diseases • recruitment and assessment of new outgrowers

[18] Activities in the Rift Valley currently are dormant following the recent election violence in that area.

Outgrowers

This looks at common aspects of the two types of EAGA outgrowers . Twenty-seven outgrowers are individuals or business partnerships and the rest are part of four self help groups (SHGs) [19], which comprise 10 to 15 small-scale farmers.

The individual outgrowers are mainly farmers with sufficient access to land or retirees from professional jobs who have invested in horticultural production to supplement their pensions. Outgrowers with a farming background tend to own most of the land they cultivate, but also rent additional acreage. The retirees may lease all land under production though many purchase at least a few acres. In general, most individual outgrowers operate farms with 4 to 6 Ha although there are a few with more than 12 Ha.

The smaller, individual outgrowers often employ between four to six full-time staff, one of whom is likely a farm manager specializing in agronomy. Depending on the plotsizes under production, these outgrowers also employ 10 to 30 part-time laborers (most of whom are women) one to three times a week for weeding and harvesting operations. Larger, individual outgrowers may employ between 40 and 60 part-time staff.

The SHGs are a collection of small-scale farmers who together are able to satisfy the requirements for producing vegetables for EAGA (see section 4.2 below). By GOK law, SHGs have elected officials (Chairman, Secretary, Treasurer and additional committee members) and are legally registered business entities that are exempt from certain business taxes. SHGs also appoint a member or hire a *grader* to grade all members' harvests prior to collection by EAGA. The grader often is paid a modest amount for the service. In addition, they appoint a s*cout* to monitor members' farms for pests and communicate with the EAGA TA (see below).

SHG members own most of the land they cultivate although some lease extra plots from neighbors. Of their own land, each member has roughly one hectare, half of which they reserve for subsistence crops. Each member is responsible for his/her production, but EAGA and the SHG committee coordinate what and when to plant.

While SHG outgrowers must adhere to the same requirements and standards as individual outgrowers, their operations differ in important ways as illustrated in the following table.

Table 2: Key operational differences

Individual Outgrowers	**SHG Outgrowers**
Use of tractors for clearing and preparing land	Little to no use of mechanized tilling equipment
Use of motorized water pumps and storage cisterns for irrigation, some drip irrigation	Use of treadle pump or gravity flow for flood irrigation
Hired labor	Mainly own labor

[19] SHG are formal businesses comprising groups of small-holders organized according to applicable GOK regulations.

4.2. Method of Selecting Outgrowers

EAGA field staff (TAs and AMs) is responsible for identifying and recruiting new outgrowers. Historically, EAGA has had little difficulty identifying outgrowers as many qualified farmers typically inquire with EAGA for outgrowing opportunities. There are other instances when EAGA has actively recruited an outgrower due to geographical location or perceived capability. At present, EAGA is in the process of reducing the number of outgrowers and is reviewing how many it intends to retain.

To be selected as an individual outgrower or SHG the candidate must satisfy the following requirements:

- Formal registration with the GOK
- Access to at least 4 Ha of land, which can be owned or leased
- Reliable, year-round access to water
- Soil quality suitable for the crops to be grown
- Soil that previously has not been exposed to contaminants or that runs the risk of future exposure
- Farm infrastructure in compliance with standards for grading sheds, charcoal-cooler / storage sheds[20], hygienic toilets, safe and hygienic storage facilities for chemicals and fertilizers, accessible hand-washing facilities and proper signage instructing workers on hygienic standards and safety procedures
- Personnel appointed to the tasks of grading harvested production and scouting for pests and diseases
- Record keeping systems that document all farm activities including planting cycles, all input use and harvest times
- Required infrastructure, personnel and record keeping systems are in place within one year of signing an outgrower contract.

EAGA typically schedules new outgrowers to produce only small quantities of vegetables initially. Production amounts increase as the outgrower becomes more experienced and trusted.

4.3. Procurement / Distribution of Seeds and Inputs to Farmers

EAGA supplies all outgrowers with high-quality, hybrid seed from international providers such as Royal Sluis. The amount of seed distributed is based on EAGA's estimated market demand. For example, EAGA distributes sufficient seed for outgrowers to plant a total of 13 Ha per week of fine beans, 11 Ha of snow peas and 2 Ha of sugar snaps. However, as the low-season approaches, EAGA reduces the seed it distributes in accordance with lower expected demand.

EAGA deducts the cost of seed from payments to outgrowers and does not include administrative or transportation costs. For SHG outgrowers, EAGA distributes seeds to the SHG committee which is then responsible for assuring that its members receive the appropriate amounts and varieties of seed.

[20] Charcoal cooling sheds have walls with 8-10cm of charcoal between wire mesh that is kept moist to cool the interior.

EAGA previously distributed other inputs to outgrowers but ceased this activity for the following two reasons.

1. Compliance with international standards proscribes using collection vehicles to transport agro-chemicals. To maintain its distribution of inputs, EAGA would have had to invest in a second set of distribution vehicles, which was too expensive.
2. Outgrowers have little or no difficulty obtaining appropriate agro-chemicals from local suppliers[21]. EAGA does, however, supply all outgrowers with a list of agro-chemicals that are in compliance with international standards, and before applying most agro-chemicals outgrowers consult with EAGA.

Given the company's increasing challenge of ensuring outgrower loyalty and reducing side-selling, EAGA is re-assessing whether to renew the distribution of other inputs. See section 5 below for more details.

4.4. Coaching / Training Contract Farmers

EAGA invests heavily in training its outgrowers, which takes place in different ways. The majority of coaching and training comprises one-on-one sessions between outgrowers and TAs during the latter's weekly visits. AMs reinforce TA advice during their periodic visits and tAs provide additional training by working closely with outgrowers to solve problems as they arise.

Outgrowers also get to exchange experiences with other outgrowers in meetings EAGA organizes. For two to three days each year outgrowers discuss farm management and technical issues and compare approaches to solving particular problems. In addition, EAGA offers a range of technical workshops tailored to farm managers, new outgrowers and on-farm specialists like graders and scouts. Workshops occur once or twice a year, sometimes more often and the company contracts out development and facilitation of the workshops to training companies. Some recent workshop themes include the following:

- Orientation and training for new outgrowers in horticulture, farm management, grading, etc.
- Changes in market requirements, standards and measures farmers must adopt to be in compliance
- Strategies for improving yields
- Strategies for managing pests
- Strategies for improving farm operations and managing production costs
- Grading product (for designated graders)
- Identifying pests and monitoring crops (for designated scouts and/or farm managers).

[21] In one instance, a local supplier agreed to seven-day credit terms for members of one SHG; an arrangement negotiated by the SHG Chairman and Agro-Vet owner with no support from EAGA staff.

4.5. Technical Assistance to / Monitoring of Contract Farmers

In addition to their coaching responsibilities, EAGA TAs closely monitor outgrowers for compliance with the myriad requirements of international and supermarket standards. TA monitoring responsibilities include the following:

- Assess the risks of contamination for every plot planted or replanted and report on the history of crops planted, inputs used, the reliability and quality of water sources and existing and potential contamination threats
- Communicate the planting schedule of
- Monitor the production stages (growth, flowering and fruiting, and estimated harvest time) and assure appropriate farming activities take place in accordance with the production stage[22]
- Monitor and control for diseases and pests or respond to reports from scouts and determine interventions for outgrower
- Estimate harvest projections in terms of quantity and timing and report findings to the AM
- Monitor how production is harvested and collected
- Ensure outgrowers are in compliance with all record keeping system standards —input use, production cycles, harvest records, etc.—as well as hygienic and safe practices for storing inputs and using farm equipment, e.g. sprayers
- Inspect sprayers and calibrate emission rates to ensure standard rates of application of chemicals.

The audit division from EAGA's Nairobi office audits each outgrower and farm plot annually for compliance with the above. The auditors' findings are included in the company's applications for GlobalGap and UK supermarkets' certification regimes.

4.6. Contracting and pricing strategies

EAGA has a simple one-year contract with its outgrowers that can be renewed annually if both parties agree. Its simplicity is designed to communicate clearly the expectations of the company vis-à-vis its outgrowers rather than serve as a legal document whose enforcement is doubtful. The basic elements of the contract are:

- Outgrowers agree to abide by EAGA's instructions and assure their compliance with the requirements of GlobalGap and other standards of EAGA buyers
- Outgrowers agree to pay back EAGA for the seed they receive
- Outgrowers agree to sell EAGA the vegetables they produce and not sell either the vegetables or the seed to third parties
- EAGA agrees to pay outgrowers a floating market-rate for their vegetables.

The market-rate that EAGA pays its outgrowers is the spot price local brokers pay. This information is gathered in a seemingly unsystematic way by many of the major exporting companies such as Homegrown and Sunripe. These companies and EAGA share this information

[22] For example, certain chemicals are proscribed in the weeks prior to harvesting.

in order to stay abreast of spot market-rates and set their outgrower pricing strategies accordingly.

EAGA made the decision to pay outgrowers a floating market-rate in February 2007. Before this, EAGA paid a fixed rate, but due to an increase in competition from buyers of vegetables and an upward trend in spot-market prices, EAGA's outgrowers requested that prices be allowed to float with the market. After a series of consultative meetings with outgrowers, EAGA management altered the contracts accordingly.

Notably absent from the contract are assurances that EAGA will purchase all the outgrowers' vegetables, even if they are produced using EAGA-distributed seed and satisfy all quality standards. While some outgrowers view this as an important failing of the contract, EAGA is unable to make such assurances given the volatility of its own buyers' demands, especially during the low-season months.

4.7. Procurement operations

EAGA knows the anticipated production of its outgrowers in advance as it is based on the company's planting schedule for outgrowers (see section 4.3 above). The exact dates and amounts to be collected are monitored by EAGA TAs and coordinated between the AMs and the Nairobi pack-house. The procurement process runs roughly as follows:

- The outgrower harvests the vegetables; grades them in the grading shed; packages saleable vegetables in crates[23]; affixes labels identifying the farm plot, outgrower, and product; and stores crates in a charcoal cooling shed
- EAGA's refrigerated truck collects the vegetables and, after other collection stops, transports them to the pack-house
- At the pack-house, inspectors verify the shipment and determine if the quality is sufficient [24]. Once accepted, samples are taken to verify MRLs[25].
- Further grading takes place as employees pack vegetables in ready-to-sell plastic containers, which then go to the pre-shipment cooling room
- Vegetables that do not pass inspection or grading are returned to the outgrower
- Payment is transferred to the outgrower's bank account two to three weeks later based on the quantities accepted less the cost of seed
- A printed report is sent to the outgrower with the following: payment transferred, volumes and value of vegetables accepted, reasons for rejection and the cost of seed.

In the case of SHGs, payments are wired to the group's account and the report is sent to the Chairman of the SHG committee, who is responsible for ensuring payments go to individual producers. According to EAGA staff, the tardiness or failure to forward payments to members or

[23] Crates are supplied by EAGA.
[24] At least 60% of a received crate's contents must immediately appear able to pass quality control standards.
[25] Laboratories in Europe conduct the MRL tests; it is less expensive there and more reliable than tests conducted in Nairobi.

lack of transparency in the process are the top causes of group failure. Although EAGA recognizes this issue, it is not allowed to intervene in SHG internal functions.[26]

4.8. Incentives for Farmers

The main incentives for farmers to become EAGA outgrowers are:

- The market for their crops is nearly assured and farmers do not have to spend time or money on marketing activities
- Small-scale SHG farmer-members can make better use of their existing land by producing cash-crops, which might otherwise remain fallow if they produced only for subsistence
- Farmers have access to technical assistance and training and to expensive, high-quality seeds, which results in much higher yields than many would achieve on their own.

Conversely, many outgrowers identified the following actions of exporters (not just EAGA) as detrimental to the outgrower-exporter relationship:

- Lack of respect and encouragement
- Failure to collect production or to collect it late
- Failure to communicate regularly
- Disorganized and unreliable technical support
- Lack of flexibility and openness to discuss changes and improvements to contract arrangements
- High rejection rates and exporters' lack of alternative markets for vegetables that fail to pass the stringent physical standards of some buyers but which are otherwise acceptable[27].

5. Fundamentals of Success

According to EAGA management, the most important elements of its success with outgrower operations have been its ability to:

1. ***Be flexible and respond dynamically to change***: Since the company began 20 years ago, the market for fresh vegetable exports has changed dramatically as have relations with outgrowers. The major forces behind these changes include:
    - Increased complexity of market requirements, e.g. GlobalGap and supermarket standards
    - Increased competition from new entrants to vegetable exporting, many of whom do not have their own farms or outgrowers
    - Pressures on outgrowers in terms of lower water availability, increasing costs of production and diminishing yields.

[26] Partially to address SHG payment issues , EAGA has begun holding monthly meetings with SHG members in an area where payment issues can be raised with its representatives and immediately furnishes reports so members can pursue matters with their SHG Chairmen.

[27] An EAGA competitor estimates that nearly 50% of what it collects from outgrowers is returned or dumped for failing to meet buyer standards.

In response, EAGA has progressively altered its outgrower operations and changed its policies. As noted above, EAGA is reviewing whether to start providing more inputs to help lower production costs and further secure outgrower loyalty.[28] In addition, EAGA can threaten to stop distribution of these high-quality, low-cost inputs to outgrowers and eject them from its program if they side-sell.

2. ***Provide good quality, readily available technical assistance, training and support:*** Outgrowers value these services as they provide a certain degree of assurance about EAGA's commitment and they reduce the farmers' risk of loss when producing crops like exportable vegetables that entail high costs of production.

3. ***Provide opportunities for outgrowers to communicate with all levels of the company:*** EAGA recently began holding monthly meetings with outgrowers to allow them direct access to staff other than the TAs and AMs and to improve EAGA's overall understanding of their issues.

4. ***Be organized and punctual:*** Outgrowers view EAGA as a credible partner because its logistics and technical support are well organized and dependable.

5. ***Provide year-round market access:*** Many of EAGA's competitors, especially the new entrants, are unable to assure a market in the low-season, which effectively differentiates the company and makes being an outgrower for EAGA a valuable opportunity.

6. Biggest challenges

EAGA's biggest challenge is outgrower loyalty and the side-selling of both seed and harvested vegetables. The new exporters entering the market, the rise in the number of local brokers and traders and the swiftness with which prices are communicated by cell-phone have all exacerbated the problem of side-selling.

Another challenge for the company is the stability of the SHGs. Much energy and effort is expended to bring a group of 10 to 15 small-scale farmers into compliance with international standards and to produce good quality vegetables. The structure of SHGs and EAGA's inability to intervene in their internal workings increases the risk of working with such groups, despite the value that many of EAGA's buyers place on such arrangements.

Lastly, EAGA is challenged to find solutions to a host of technical problems that increasingly weigh on outgrowers across Kenya. These issues include i) the lack of available land for outgrowers and EAGA to buy or lease for larger-scale farming, ii) lower water levels, and iii) higher costs of production brought on mainly by rising costs for fuel and nearly all farm inputs.

[28] Conversely, the company also is evaluating whether to reduce the overall amount it purchases from outgrowers in favor of its own farms; instead of purchasing 60% from outgrowers, reduce that progressively to 40% and then to 20%.